CVS Corporation 2003 Annual Report

CVS easy...

CVS is one of the nation's largest and fastest-growing drugstore chains, with 4,179 stores in 32 states and the District of Columbia. The mission of our 110,000 associates can be summed up in two words: CVS easy™. We want to be nothing less than the easiest pharmacy retailer for customers to use. That means convenient locations, drive-thru pharmacies, 24- and extended-hour stores, and 1-hour photo labs with digital capabilities. It also means clean, neat stores with superior customer service and prescriptions that are ready when promised.

Sales in 2003 reached a record-breaking $26.6 billion, generated by our retail locations and by PharmaCare Management Services, our PBM and specialty pharmacy division. With retail sales exceeding $800 per square foot, CVS averages approximately $100 more per square foot than our nearest competitor and $200 more per square foot than the industry average. We hold the #1 market position in seven of the top 10 U.S. drugstore markets and the #1 or #2 market rank in nearly two-thirds of the top 100 U.S. drugstore markets in which we operate.

CVS trades on the New York Stock Exchange under the symbol "CVS" and at year-end had a market capitalization of more than $14 billion.

On the cover: The Titusville CVS/pharmacy location that opened in November 2003 is one of our new stores in the fast-growing Florida markets.

Message from our Chairman

Chairman, President, and CEO Tom Ryan visits Store Manager Terri Chalifoux at the CVS/pharmacy in Wakefield, Rhode Island.

TO OUR SHAREHOLDERS:

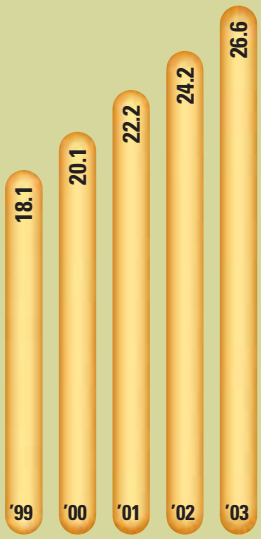
CVS can look back over 2003 with a great sense of accomplishment. We turned in the best performance in our 40-year history, with sales hitting an all-time high of $26.6 billion. Our sales results improved steadily throughout the year, finishing with a record-breaking holiday season. Same-store sales grew by 5.8 percent, while diluted earnings per share rose a healthy 17.7 percent, to $2.06. Much of the credit for these results can be attributed to the success of our associates' efforts to make CVS the easiest pharmacy for customers to use. Our research shows that customers are noticing the difference.

Our pharmacy business, which accounts for roughly 70 percent of overall sales, turned in a tremendous year. Pharmacy same-store sales jumped 8.1 percent, with CVS filling more than one in every 10 U.S. retail drug prescriptions. Front-end same-store sales increased 1.2 percent. We also saw improvements in gross margins, due largely to increased generic drug sales, a significant reduction in inventory losses, and a more profitable product mix in the front of the store. These are just some of the strong underlying fundamentals that helped CVS' share price increase 45 percent in 2003 versus a 23 percent increase for the S&P 500.

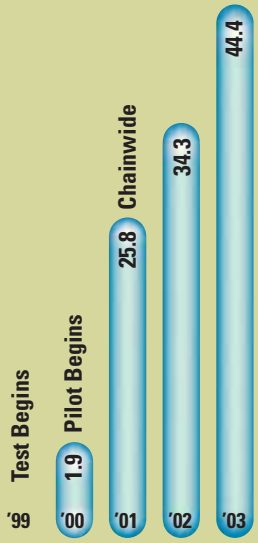
Our balance sheet remained among the best in our industry, with low leverage and excellent working capital ratios. We generated a significant amount of cash and continued to put this money to use on a number of fronts—opening stores, investing in technology, and increasing our dividend payout. In fact, the 15 percent dividend hike we announced in October was the largest since we went public in 1996, reflecting our strong results and confidence in our future. Our return on invested capital increased to 9.9 percent, with the spread above our weighted average cost of capital once again demonstrating economic value creation.

GROWING OUR STORE BASE

We continued our successful expansion, opening 275 convenient new stores in 2003. After factoring in relocations and closings, we achieved a 3.5 percent expansion in square footage and net unit growth of 92 stores. Of these, more than 80 are located in fast-growing new CVS markets such as Florida, Texas, Chicago, Phoenix, and Las Vegas. We also broke ground for a distribution center in Ennis, Texas, scheduled to open in late 2004. The first facility of its kind in North America, it will utilize state-of-the-art storage and retrieval systems that are 30 percent more productive and require half the space of traditional distribution centers.



Sales *(In billions of dollars)*



ExtraCare Cardholders *(In millions)*

Forty percent of all U.S. households participate in the CVS ExtraCare loyalty program.

REAPING THE BENEFITS OF "CVS EASY"

Through our "CVS easy" initiatives, we've worked hard to make ours the easiest stores to shop among all drug retailers. Take our Pharmacy Service Initiative, which we rolled out during the year. Based on tracking studies, we have seen substantial improvements in service levels and have received overwhelmingly positive customer feedback. Our ExtraCare® program, with more than 44 million cardholders, is the largest and most successful U.S. retail loyalty program. Three years after ExtraCare's rollout, cardholders account for a remarkable 55 percent of all transactions and are enjoying the program's many benefits.

Assisted Inventory Management (AIM), the computerized inventory tracking system we introduced in 2002, has dramatically improved our in-stock position in the front of the store. AIM helped us exceed our inventory-turn goal in 2003, making us the leader among national drugstore chains in this important productivity measure. We achieved inventory turns of 5.0 times for the year, up from 4.6 times in 2002. Furthermore, we rolled out AIM for the pharmacy in 2003 and anticipate substantial benefits as 2004 progresses.

In July 2003, CVS also became the first national drug retailer to offer self-service digital photo printing. Customers have noted their approval of our easy-to-use kiosks by printing more than 25 million images through year-end. This has reversed the downward trend in the overall photo category caused by the drop in traditional overnight processing.

Our "CVS easy" mission even drives the way we design our stores, with a focus on enabling customers to get what they want as conveniently as possible. They appreciate our more than 1,700 drive-thru pharmacies, carpeted floors, good lighting, and five-foot shelf heights that make it easy to find and reach every product. We've expanded store hours as well, with 1,600 stores—double last year's level—now offering 24- or extended-hour service. This strategy is paying off. CVS boasts the highest sales per retail square foot of any national drugstore chain, hitting more than $800 in 2003. More than 50 percent of our stores were freestanding at the end of 2003, and we expect that figure to reach 70–80 percent over the long term. On the pages that follow this letter, I invite you to witness "CVS easy" in action.

Financial Highlights

In millions, except per share	*2003 (53 weeks)*	*2002 (52 weeks)*	*% Change*
Sales	**$ 26,588.0**	**$ 24,181.5**	**10.0**
Operating profit	**1,423.6**	**1,206.2**	**18.0**
Net earnings	**847.3**	**716.6**	**18.2**
Diluted earnings per common share	**2.06**	**1.75**	**17.7**
Stock price *at year end*	**36.12**	**24.97**	**44.7**
Market capitalization *at year end*	**14,281**	**9,814**	**45.5**

OFFERING A UNIQUE FRONT-END EXPERIENCE

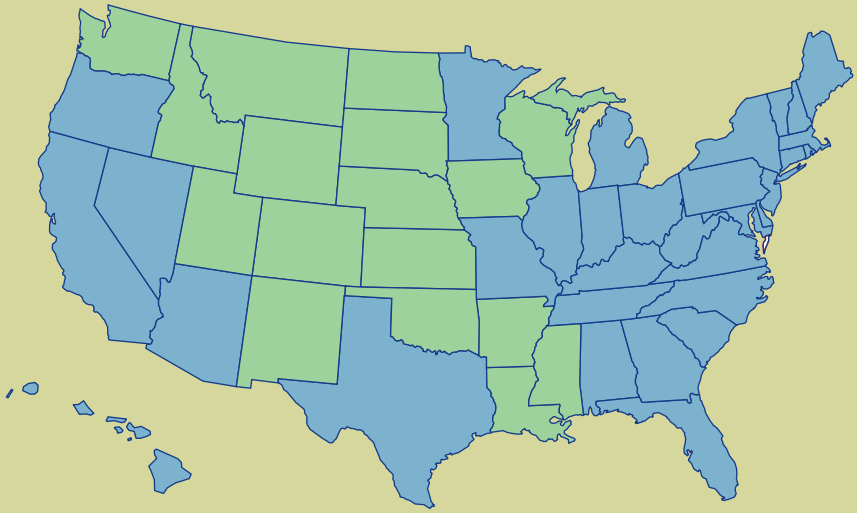
We've distinguished ourselves in other ways as well. For example, CVS offers a unique front-end focus on cosmetics, health, and beauty. We carry France's Avène® and Vichy® beauty care lines and are currently the exclusive U.S. distributor of Finland's Lumene® brand. It's worth noting that 40 percent of our Lumene customers are new to the skin care category at CVS, a clear indicator that such offerings help drive front-of-store sales growth. In addition, customers value the way we tailor our stores with merchandise targeted to ethnic preferences and the other needs of distinct neighborhoods. Our web site, CVS.com, offers the ability to order unique products online.

With our PharmaCare® subsidiary, which celebrates its 10th anniversary in 2004, we've built one of the most comprehensive U.S. pharmacy benefit management (PBM) and specialty pharmacy companies. The fourth-largest PBM overall with 15 million members, PharmaCare is recognized as the leader in offering a full-service solution for small and mid-sized clients. Its 17 percent jump in revenue in 2003 pushed PharmaCare's annual sales past $1.3 billion. I'm happy to note that PharmaCare also continues to benefit from enhanced sales and marketing efforts following the integration of ProCare, our specialty pharmacy division.

CVS also tries to make it easy for doctors to maximize their time spent with patients. We are a charter member of SureScripts, an organization formed to provide an electronic link between doctors and pharmacies. This should help make the prescription-filling process faster and more efficient, and a highly promising beta test is currently underway in Rhode Island. We expect the necessary connections to be deployed nationwide by year-end 2004, with acceptance by prescribers occurring over time.

EXPECTING MORE GOOD NEWS IN 2004 AND BEYOND

We are committed to steady, long-term, profitable growth. As we enter 2004, I have reason to feel very optimistic about CVS' prospects. For starters, we've built a top-notch management team that is focused on transforming a good retailer into a great one. Our team includes a number of individuals who have spent close to two decades with CVS, as well as professionals who have joined us from other industries. The resulting breadth of our executive talent has made us a stronger organization, ready to seize new opportunities. Moreover, we have clarity of mission among the 110,000 associates who are putting our "CVS easy"



CVS/pharmacy and ProCare Markets *(In blue)*

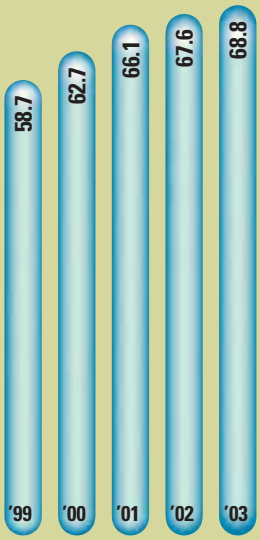
initiatives into action every day and helping us unlock our enormous potential. It's worth noting that length of service averages 10 years for our 4,000-plus store managers and nine years for our more than 12,000 pharmacists. Extensive experience and our Emerging Leaders development program help prepare our top talent for broader field management roles.

EXPANDING OUR PRESENCE IN NEWER MARKETS

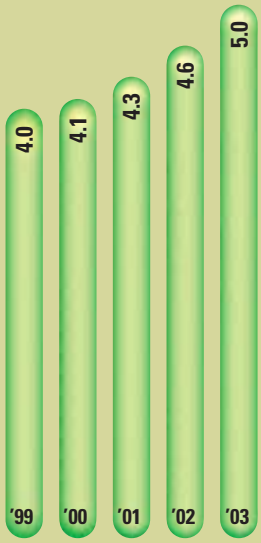
We fully expect sales to pass $28 billion in 2004. Some 225–250 new or relocated stores are slated to open during the year, and total square footage should grow by approximately 4 percent again. Nearly all of the net store growth will come from increased penetration in our newer markets. After only three years, these newer markets will contribute more than $1 billion in revenue in 2004. We also plan to enter other high-growth areas such as Minneapolis, Los Angeles, and Orange County, California.

The retail pharmacy industry is expected to more than double to about $450 billion in annual sales by 2012. Our pharmacies stand to benefit from a strong drug discovery pipeline as well as the FDA's accelerated approval of generic drugs. Some $50 billion in pharmaceuticals will be coming off patent over the next four years. Demographics also continue to work in our favor. The population is aging, and prescription drug therapy remains a cost-effective approach to meeting health care needs. People aged 65 and over use almost four times as many prescriptions as other individuals. According to government estimates, this portion of the population will spend $1.8 trillion on prescriptions over the next decade.

The competitive threat of mail order pharmacy has been a much debated issue, with consumer resistance growing against benefit plans that force patients to order maintenance medications through the mail. We are encouraged by the overwhelmingly positive response to benefit plans that allow customers to fill their 90-day prescriptions in retail stores. Let me stress that CVS does not oppose dispensing medication through mail order. However, we are opposed to a small number of PBMs implementing plan designs that not only force patients to use mail, but also dictate that patients use their captive mail order services. At best, this practice is harmful to patients because it eliminates choice and deprives them of the opportunity to obtain personal counseling from a community pharmacist. At worst, it is unfair and anti-competitive.



Rx Sales/Total Sales *(In percent)*



Inventory Turns

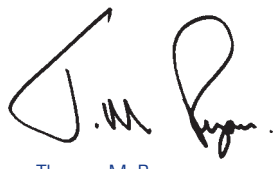
Inventory turns improved 7 percent on average for five consecutive years, making CVS #1 among national chains.

In November, we watched Congress pass a long-awaited prescription drug law that goes into effect in 2006. Many of its details have yet to be worked out, and we will monitor them closely. However, we believe that this kind of legislation will ultimately be good for senior citizens, good for this country's uninsured, and good for CVS. IMS Health predicts that a Medicare prescription benefit would add 75–100 million incremental prescriptions to the market annually.

BUILDING ON A STRONG CORPORATE GOVERNANCE TRADITION

Another piece of federal legislation, the Sarbanes-Oxley Act, has garnered a great deal of attention of late. Enacted to improve corporate governance standards, you may be wondering what impact it will have on CVS. Thanks to a strong corporate governance tradition, built over our 40 years in business, CVS has had to make very few changes. In fact, we are largely formalizing and documenting already existing practices. As for our Board of Directors, it has always included talented leaders from corporate America, academia, and the non-profit world. Among them, I want to extend a special thanks to Ivan Seidenberg and Eugene Applebaum. Both men served faithfully for many years and retired following our last annual meeting.

In closing, I want to thank long-standing shareholders for the continued confidence you place in our efforts. If you're new to CVS, then you've become a shareholder during a most exciting period. We are a company with a long history, to be sure, but "CVS easy" and the other initiatives I've described above demonstrate that we are not encumbered by old ways or old ideas. The eagerness to challenge ourselves and our passion for extraordinary customer service drive everything we do. I believe that CVS has the talent, the focus, and the financial strength to create new growth opportunities for years to come.



Thomas M. Ryan
Chairman of the Board, President, and Chief Executive Officer

February 12, 2004

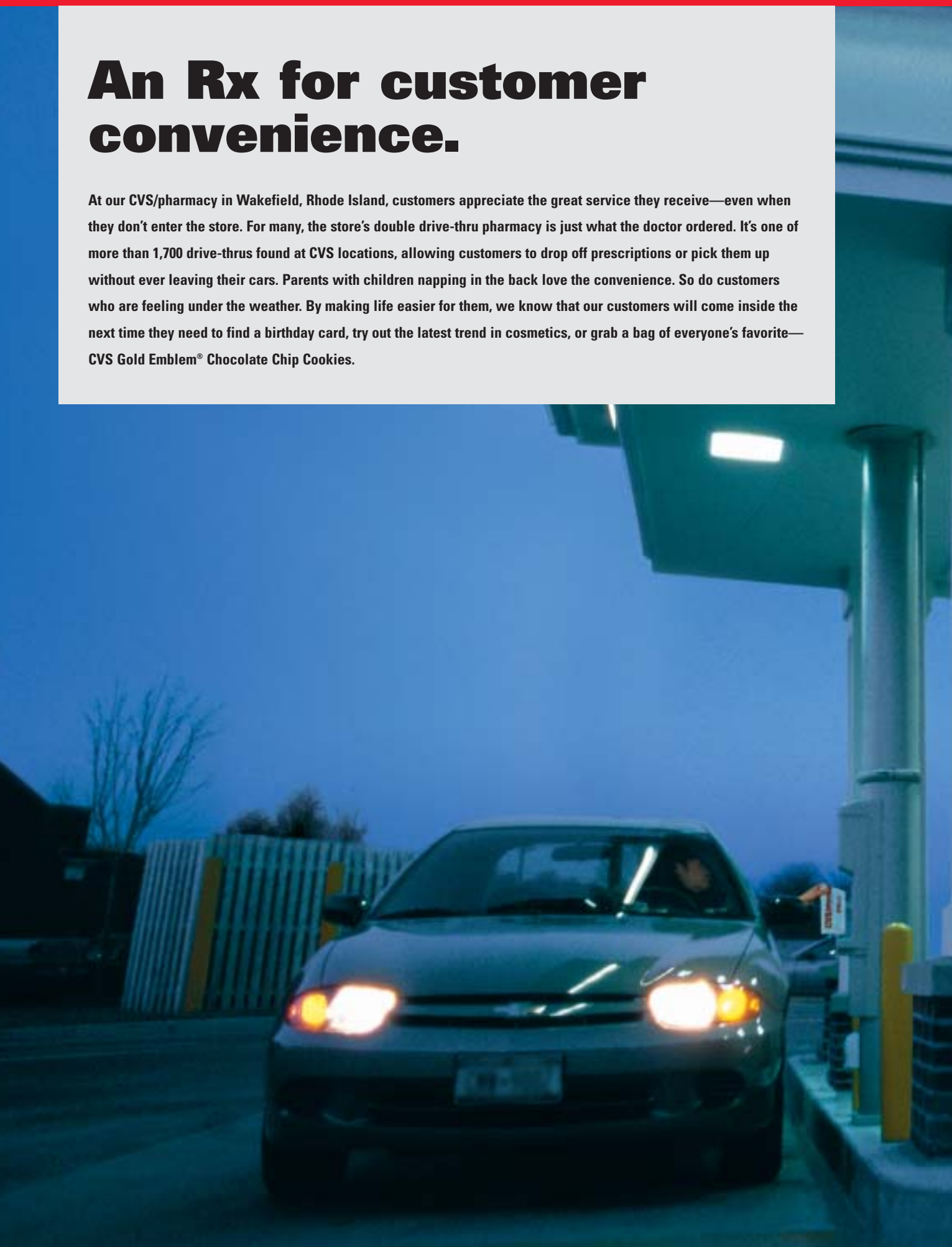
CVS
SHIFT SUPERVISOR
$$$$$ EXTRACARE COUPON $$$$$
SAVE $4 OFF $20
47943
CVS/pharmacy
ExtraCare

Making it easy to save.

At this CVS/pharmacy in Jamaica Plain, Massachusetts, customers love to flash their ExtraCare® cards for Shift Supervisor Eve Rodriguez—with good reason. ExtraCare lets customers at every location enjoy advertised discounts without the hassle of clipping coupons. Cardholders also get a little something back with their sales receipts every quarter: ExtraBucks™. Customers can apply these cash rewards toward just about any front-of-store purchase—and keep a few more dollars in their pockets. They may receive tailored promotional offers as well. How successful have our ExtraCare/ExtraBucks efforts been? With more than 44 million cardholders, CVS has the largest retail loyalty program in the United States.

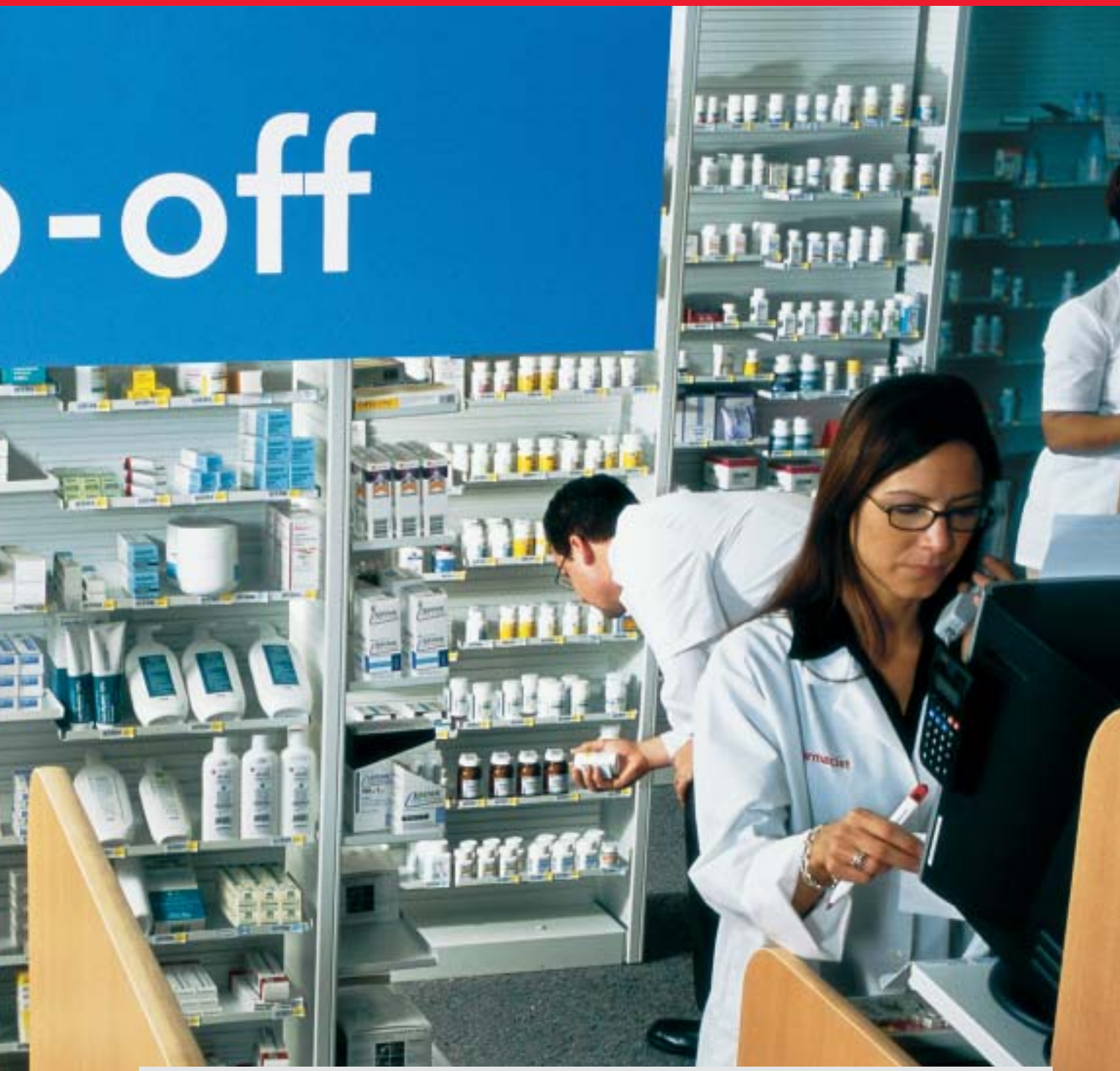
An Rx for customer convenience.

At our CVS/pharmacy in Wakefield, Rhode Island, customers appreciate the great service they receive—even when they don't enter the store. For many, the store's double drive-thru pharmacy is just what the doctor ordered. It's one of more than 1,700 drive-thrus found at CVS locations, allowing customers to drop off prescriptions or pick them up without ever leaving their cars. Parents with children napping in the back love the convenience. So do customers who are feeling under the weather. By making life easier for them, we know that our customers will come inside the next time they need to find a birthday card, try out the latest trend in cosmetics, or grab a bag of everyone's favorite—CVS Gold Emblem® Chocolate Chip Cookies.



DRIVE-THRU/pharmacy
EXIT

drop



Ready when promised.

At one of our newest locations—in Coconut Grove, Florida—customers have come to expect a high level of service at the pharmacy. And we wouldn't have it any other way. Thanks to the Pharmacy Service Initiative (PSI) we rolled out in every CVS/pharmacy in 2003, our pharmacy teams are able to make the prescription-filling process easier by verifying insurance, medication availability, or refill authorization on the spot. As a result, we resolve potential problems while customers are still at drop-off. PSI also gives them a high degree of confidence that prescriptions will be filled and "ready when promised." For Cristina Fueyo (left), Nicole Povich, and our other 12,000-plus pharmacists, PSI also means that they have more time to spend counseling customers and providing the best service possible.

QUICK and EASY from any digital camera card
Picture Maker
Digital Station
Kodak
.29 ¢

Developing a digital solution.

Printing digital photos has never been easier (or more fun) for this mother and child in Dallas, Texas. That's because they're using one of our self-service digital photo kiosks now found in more than 3,200 CVS/pharmacy locations around the country. In July 2003, CVS became the first national retailer to offer this service. We're making it a snap for customers to retrieve images from their digital cameras, film, CDs, or camera phones—and to crop, enlarge, and print them on high-quality Kodak paper while they shop. All for just 29 cents a shot. The response? We've sold 25 million images and counting.

VICKS
NyQuil
CVS
NIGHT TIME
COLD/FLU
4.49

AIMing to be the best.

When customers at this CVS/pharmacy in Washington, D.C., ask store manager Hobart Banks for help finding a product, he's confident that the items are on the shelf. After all, we've taken the guesswork out of inventory tracking at all locations with our computerized Assisted Inventory Management (AIM) system. Introduced in 2002, AIM has since helped to dramatically improve our in-stock position and the CVS shopping experience. More good news is coming in 2004 as we reap the benefits of the recent AIM rollout in the pharmacy.

Always ready to help.

In Seminole, Florida, Pharmacy Supervisor Alan Obringer and Pharmacy Manager Susan Villella recently found themselves back in grade school. That's because both are part of a team of CVS associates who volunteer their time in Bauder Elementary School's Science Lab. Through our Volunteer Challenge Grants Program, the school also received funding for supplies and experiments. The CVS Charitable Trust awarded 200 such grants in 2003 to non-profit organizations where CVS associates volunteer. This is just one of the many ways in which we support our communities. Over the past year, the CVS Charitable Trust also awarded grants to nearly three-dozen organizations across the country working to improve children's health care and quality of life for people in need. The CVS Charity Classic, our largest single philanthropic event, distributed more than $1 million in 2003 to nonprofits. Our associates provide supplies during natural disasters and other emergencies as well, as they did by distributing bottled water, flashlights, and batteries during the blackout of 2003.

2003 Financial Report

Management's Discussion and Analysis of Financial Condition and Results of Operation **18**

Consolidated Statements of Operations **26**

Consolidated Balance Sheets **27**

Consolidated Statements of Shareholders' Equity **28**

Consolidated Statements of Cash Flows **29**

Notes to Consolidated Financial Statements **30**

Five-Year Financial Summary **46**

Management's Responsibility for Financial Reporting **47**

Independent Auditors' Report **47**

Management's Discussion & Analysis of Financial Condition and Results of Operation

The following discussion should be read in conjunction with our audited consolidated financial statements and our Cautionary Statement Concerning Forward-Looking Statements that are presented in this Annual Report.

OUR BUSINESS

Our company is a leader in the retail drugstore industry in the United States. We sell prescription drugs and a wide assortment of general merchandise, including over-the-counter drugs, greeting cards, film and photo finishing services, beauty products and cosmetics, seasonal merchandise and convenience foods through our CVS/pharmacy® retail stores and online through CVS.com®. We also provide Pharmacy Benefit Management and Specialty Pharmacy services through PharmaCare Management Services. As of January 3, 2004, we operated 4,179 retail and specialty pharmacy stores in 32 states and the District of Columbia. Please see Note 10 to our consolidated financial statements for further information on our business segments.

RESULTS OF OPERATIONS AND INDUSTRY ANALYSIS

The Company's fiscal year is a 52 or 53 week period ending on the Saturday nearest to December 31. Fiscal 2003, which ended on January 3, 2004, included 53 weeks. Fiscal 2002 and 2001, which ended on December 28, 2002 and December 29, 2001, respectively, included 52 weeks. Unless otherwise noted, all references to years relate to these fiscal years.

Net sales ~ The following table summarizes our sales performance:

	2003	*2002*	*2001*
Net sales *(in billions)*	**$ 26.6**	$ 24.2	$ 22.2
Net sales increase:			
Total	**10.0%**	8.7%	10.7%
Pharmacy	**11.9%**	11.2%	14.5%
Front store	**5.7%**	3.8%	3.9%
Same store sales increase:			
Total	**5.8%**	8.4%	8.6%
Pharmacy	**8.1%**	11.7%	13.0%
Front store	**1.2%**	2.3%	1.2%
Pharmacy % of total sales	**68.8%**	67.6%	66.1%
Third party % of pharmacy sales	**93.2%**	92.3%	90.9%
Prescriptions filled *(in millions)*	**335**	316	309

As you review our net sales performance, we believe you should consider the following important information:

— Total net sales from new stores accounted for approximately 350 basis points of our total net sales increase in 2003 and 210 basis points in 2002.

— Total net sales continued to benefit from our ongoing relocation program, which moves existing shopping center stores to larger, more convenient, freestanding locations. Historically, we have achieved significant improvements in customer count and net sales when we do this. Our relocation strategy remains an important component of our overall growth strategy, as only 51% of our existing stores were freestanding as of January 3, 2004.

— Total net sales benefited from the 53rd week in 2003, which generated $530.8 million in net sales. If you exclude the impact of the 53rd week, net sales on a comparable 52-week basis, increased 7.8% in 2003 when compared to 2002.

— Pharmacy sales continued to benefit from new market expansions, increased penetration in existing markets, our ability to attract and retain managed care customers and favorable industry trends. These trends include an aging American population that is consuming more prescription drugs, the availability of new prescription drugs, and the increased use of pharmaceuticals as the first line of defense for individual healthcare. We believe these favorable industry trends will continue.

— Pharmacy sales were negatively impacted in all years by the conversion of brand named drugs to equivalent generic drugs, which typically have a lower selling price. However, our gross margins on generic drug sales are generally higher than our gross margins on equivalent brand named drug sales.

— Front store sales benefited from an increase in promotional programs in 2002 that were designed to respond to competitive and economic conditions, and from the implementation of our Assisted Inventory Management system, which increased our in-stock positions.

— Total net sales were negatively impacted in 2002 by the 229 stores that were closed as part of a strategic restructuring program. We estimate that the impact of closing these stores reduced our total net sales growth by approximately 120 basis points in 2002. We further estimate that sales transferred from these stores to nearby CVS stores and increased our total same store sales growth by approximately 60 basis points in 2002.

— In recent years, the growth in mail order pharmacy has outpaced the growth in retail pharmacy. Recently, a number of payors have changed their pharmacy benefit plan designs to require maintenance medications to be filled exclusively through mail order pharmacies. To address this trend, we have dropped and/or renegotiated a number of third party programs that have adopted a plan of this kind. In the event this trend continues, and we elect to withdraw from current pharmacy benefit plans, and/or decide not to participate in future programs, we may not be able to sustain our current rate of sales growth.

Gross margin, which includes net sales less the cost of merchandise sold during the reporting period and the related purchasing costs, warehousing costs, delivery costs and actual and estimated inventory losses, as a percentage of net sales was 25.8% in 2003. This compares to 25.1% in 2002 and 25.6% in 2001. As you review our gross margin performance, we believe you should consider the following important information:

— Inventory losses were 0.92% of total net sales in 2003, compared to 1.19% in 2002 and 1.52% in 2001. During 2002, we initiated a number of programs that reduced inventory losses during the second half of 2002 and we continued to see improvements in 2003. While we believe our programs will continue to provide future operational benefits, we expect the financial improvement trend realized in 2003 will be less significant in 2004. In addition, we cannot guarantee that our programs will continue to reduce inventory losses.
— Our front store gross margin rate benefited from a more profitable front store sales mix in 2003, which included increased sales of higher gross margin categories such as health and beauty.
— Our pharmacy gross margin rate benefited from an increase in generic drug sales in 2003, which normally yield a higher gross margin than brand name drug sales.
— Our total gross margin rate benefited from an earlier and more severe flu season in 2003, which increased over-the-counter product sales such as cough and cold and flu-related prescription sales, both of which generally yield higher gross margins.
— Our gross margin rate continues to be adversely affected by pharmacy sales growing at a faster pace than front store sales. On average, our gross margin on pharmacy sales is lower than our gross margin on front store sales. Pharmacy sales were 68.8% of total sales in 2003, compared to 67.6% in 2002 and 66.1% in 2001. In addition, sales to customers covered by third party insurance programs have continued to increase and, thus, have become a larger component of our total pharmacy business. On average, our gross margin on third party pharmacy sales is lower than our gross margin on non-third party pharmacy sales. Third party pharmacy sales were 93.2% of pharmacy sales in 2003, compared to 92.3% in 2002 and 90.9% in 2001. We expect these negative trends to continue.
— Our gross margin rate in 2002, was negatively impacted by higher markdowns associated with increased promotional programs that were designed to respond to competitive and economic conditions.
— Our third party gross margin rates have been adversely affected by the efforts of managed care organizations, pharmacy benefit managers, governmental and other third party payors to reduce their prescription drug costs. To address this trend, we have dropped and/or renegotiated a number of third party programs that fell below our minimum profitability standards. To date, these efforts have helped stabilize our third party reimbursement rates. However, numerous state legislatures have proposed or, at least, appear to be considering further reductions in pharmacy reimbursement rates for Medicaid and other governmental programs as well as other measures aimed at reducing their prescription drug costs. In the event this trend continues and we elect to, for any reason, withdraw from current third party programs and/or decide not to participate in future programs, we may not be able to sustain our current rate of sales growth and gross margin dollars could be adversely impacted.

Total operating expenses, which include store and administrative payroll, employee benefits, store and administrative occupancy costs, selling expenses, advertising expenses, administrative expenses and depreciation and amortization expense were 20.5% of net sales in 2003. This compares to 20.1% of net sales in 2002 and 22.1% in 2001. As you review our performance in this area, we believe you should consider the following items, which management removes in its assessment of total operating expenses because their impact affects year-to-year comparability:

— As a result of adopting Statement of Financial Accounting Standards ("SFAS") No. 142 at the beginning of 2002, we no longer amortize goodwill. Goodwill amortization totaled $31.4 million in 2001. Please see Note 4 to the consolidated financial statements for further information on the impact of adopting SFAS No. 142.

— During 2001, we recorded a $346.8 million pre-tax ($226.9 million after-tax) restructuring and asset impairment charge to total operating expenses in connection with our 2001 strategic restructuring. We also recorded a $5.7 million pre-tax ($3.6 million after-tax) charge to cost of goods sold to reflect the markdown of certain inventory contained in the stores to be closed to its net realizable value. In total, the restructuring and asset impairment charge was $352.5 million pre-tax ($230.5 million after-tax), the ("Restructuring Charge"). Please see Note 11 to the consolidated financial statements for further information on the 2001 strategic restructuring.
— During 2001, we received $50.3 million of settlement proceeds from various lawsuits against certain manufacturers of brand name prescription drugs. We elected to contribute $46.8 million of the settlement proceeds to the CVS Charitable Trust, Inc. to fund future charitable giving. The net effect of these nonrecurring items was a $3.5 million pre-tax ($2.1 million after-tax) increase in net earnings.

If you exclude the impact of the items discussed above, comparable total operating expenses as a percentage of net sales were 20.5% in 2003, 20.1% in 2002 and 20.4% in 2001.

As you review our comparable total operating expenses, we believe you should consider the following important information:

— Total operating expenses as a percentage of net sales increased during 2003 as a result of increased advertising expense, higher payroll and benefit costs and lower sales growth resulting, in part, from higher generic drug sales. The increase in payroll and benefit costs were driven by an increase in the number of 24-hour stores, new stores and the implementation costs associated with strategic initiatives such as the Pharmacy Service Initiative and Assisted Inventory Management. Whereas we do not believe the increase in total operating expenses as a percentage of net sales that occurred in 2003 will continue in 2004, we cannot guarantee that total operating expenses will decrease as a percentage of net sales in 2004.
— Total operating expenses as a percentage of net sales decreased during 2002 primarily due to completing the 2001 strategic restructuring and implementing technology initiatives such as the Excellence in Pharmacy Innovation and Care initiative ("EPIC") that helped improve customer service while lowering operating costs, particularly at the store level.

Interest expense, net consisted of the following:

In millions	*2003*	*2002*	*2001*
Interest expense	**$ 53.9**	$ 54.5	$ 65.2
Interest income	**(5.8)**	(4.1)	(4.2)
Interest expense, net	**$ 48.1**	$ 50.4	$ 61.0

The decrease in interest expense, net during 2003 primarily resulted from an increase in interest income resulting from higher average cash balances. The decline in interest expense, net in 2002 primarily resulted from lower average interest rates on our outstanding borrowings and lower average debt requirements due to improved working capital management.

Income tax provision ~ Our effective income tax rate was 38.4% in 2003, 38.0% in 2002 and 41.8% in 2001. The increase in our effective income tax rate in 2003 was primarily due to higher state income taxes. The decrease in our effective income tax rate in 2002 was primarily due to the elimination of goodwill amortization that was not deductible for income tax purposes. Our effective income tax rate was higher in 2001 because certain components of the Restructuring Charge were not deductible for income tax purposes. To better assess year-to-year performance, management removes the impact of the Restructuring Charge and uses 39.4% as a comparable 2001 effective tax rate.

Net earnings increased $130.7 million or 18.2% to $847.3 million (or $2.06 per diluted share) in 2003. This compares to $716.6 million (or $1.75 per diluted share) in 2002 and $413.2 million (or $1.00 per diluted share) in 2001. To better assess year-to-year performance, management removes the impact of the Restructuring Charge and the $2.1 million net nonrecurring gain in 2001, and uses $641.6 million (or $1.56 per diluted share) for comparable net earnings results in 2001.

LIQUIDITY & CAPITAL RESOURCES

We anticipate that our cash flow from operations, supplemented by debt borrowings and sale-leaseback transactions, will continue to fund the growth of our business.

Net cash provided by operating activities decreased to $968.9 million in 2003. This compares to $1,204.8 million in 2002 and $680.6 million in 2001. The decrease in net cash provided by operations during 2003 primarily resulted from higher accounts receivable and lower accounts payable

offset, in part, by higher net earnings. Accounts receivable increased in 2003 primarily because our January 3, 2004 year-end ended in the middle of many of our third party payors' biweekly payment cycles. Accounts payable decreased primarily due to the timing of vendor payments.

Net cash used in investing activities increased to $753.6 million in 2003. This compares to $735.8 million in 2002 and $536.8 million in 2001. The increase in net cash used in investing activities during 2003 was primarily due to acquisitions by our Pharmacy Benefit Management segment and increased acquisitions of customer lists. Capital expenditures totaled $1,121.7 million during 2003, compared to $1,108.8 million in 2002 and $713.6 million in 2001. During 2003, approximately 60% of our total capital expenditures were for new store construction, 22% for store expansion and improvements, 14% for technology and other corporate initiatives and 4% for a new distribution center in Texas, which is expected to be completed during the first quarter of 2004.

We finance a portion of our new store development program through sale-leaseback transactions. Proceeds from sale-leaseback transactions totaled $487.8 million in 2003. This compares to $448.8 million in 2002 and $323.3 million in 2001. Under the transactions, the properties are sold at net book value and the resulting leases qualify and are accounted for as operating leases. During 2001, we also completed a sale-leaseback transaction on five of our distribution centers. The distribution centers were sold at fair market value resulting in a $35.5 million gain, which was deferred and is being amortized to offset rent expense over the life of the new operating leases.

During 2004, we currently plan to invest over $1.1 billion in capital expenditures, which will include spending for approximately 225-250 new or relocated stores, including approximately 100 in new markets.

Following is a summary of our store development activity for the respective years:

	2003	*2002*	*2001*
Total stores *(beginning of year)*	**4,087**	4,191	4,133
New stores	**150**	174	126
Closed stores	**(58)**	(278)	(68)
Total stores *(end of year)*	**4,179**	4,087	4,191
Relocated stores[1]	**125**	92	122

(1) Relocated stores are not included in new or closed store totals.

Net cash used in financing activities increased to $72.5 million in 2003. This compares to $4.9 million in 2002 and $244.8 million in 2001. The increase in net cash used in financing activities during 2003 was primarily because we issued no new long-term debt in 2003. Our net debt (i.e., our total debt less our cash and cash equivalents), decreased to $233.1 million, compared to $412.7 million in 2002 and $836.3 million in 2001. During 2003, we paid common stock dividends totaling $90.6 million or $0.23 per common share. In October 2003, our Board of Directors authorized a 15% increase in our common stock dividend to $0.265 per share for 2004.

We believe that our current cash on hand, cash provided by operations and sale-leaseback transactions, together with our ability to obtain additional short-term and long-term financing, will be sufficient to cover our working capital needs, capital expenditures, debt service and dividend requirements for at least the next several years.

We had no commercial paper borrowings outstanding as of January 3, 2004. In connection with our commercial paper program, we maintain a $650 million, five-year unsecured back-up credit facility, which expires on May 21, 2006 and a $600 million, 364-day unsecured back-up credit facility, which expires on May 17, 2004. We are currently evaluating our long-term financing needs in connection with the expiration of the 364-day facility. As of January 3, 2004, we had not borrowed against the back-up credit facilities.

Our credit facilities and unsecured senior notes contain customary restrictive financial and operating covenants. These covenants do not include a requirement for the acceleration of our debt maturities in the event of a downgrade in our credit rating. We do not believe that the restrictions contained in these covenants materially affect our financial or operating flexibility.

Our liquidity is based, in part, on maintaining strong investment-grade debt ratings. As of January 3, 2004, our long-term debt was rated "A2" by Moody's and "A" by Standard & Poor's, and our commercial paper program was rated "P-1" by Moody's and "A-1" by Standard and Poor's, each on a negative outlook. In assessing our credit strength, both Moody's and Standard & Poor's consider our capital structure and financial policies as well as our consolidated balance sheet and other financial information. We do not currently foresee any reasonable circumstances under which we believe we would lose our investment-grade debt ratings. However, if our debt ratings were downgraded it could adversely impact, among other things, our future borrowing costs, access to capital markets and new store operating lease costs.

The following table summarizes our significant contractual obligations as of January 3, 2004:

	PAYMENTS DUE BY PERIOD				
In millions	TOTAL	WITHIN 1 YEAR	1-3 YEARS	3-5 YEARS	AFTER 5 YEARS
Operating leases	$ 10,788.9	$ 855.9	$ 1,574.0	$ 1,366.1	$ 6,992.9
Long-term debt	1,075.0	323.0	361.9	387.0	3.1
Purchase obligations	163.0	32.6	65.2	65.2	—
Other long-term liabilities reflected in our consolidated balance sheet	173.0	36.6	87.7	18.6	30.1
Capital lease obligations	1.3	0.2	0.4	0.4	0.3
	$ 12,201.2	$ 1,248.3	$ 2,089.2	$ 1,837.3	$ 7,026.4

OFF-BALANCE SHEET ARRANGEMENTS

Other than in connection with executing operating leases, we do not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, including variable interest entities, nor do we have or guarantee any off-balance sheet debt. We finance a portion of our new store development through sale-leaseback transactions, which involve selling stores to unrelated parties at net book value and then leasing the stores back under leases that qualify and are accounted for as operating leases. We do not have any retained or contingent interests in the stores nor do we provide any guarantees, other than a corporate level guarantee of the lease payments, in connection with the sale-leasebacks. In accordance with generally accepted accounting principles, our operating leases are not reflected in our consolidated balance sheet.

Between 1991 and 1997, the Company sold or spun off a number of subsidiaries, including Bob's Stores, Linens 'n Things, Inc., Marshalls, Kay-Bee Toys, Wilsons, This End Up and Footstar, Inc. In many cases, when a former subsidiary leased a store, the Company provided a corporate level guarantee of the store's lease obligations. When the subsidiaries were disposed of, the Company's guarantees remained in place, although each purchaser indemnified the Company for any lease obligations the Company was required to satisfy. If any of the purchasers were to become insolvent and failed to make the required payments under a store lease, the Company could be required to satisfy these obligations. As of January 3, 2004, the Company guaranteed approximately 706 stores with leases extending through 2018. Assuming that each respective purchaser became insolvent, and the Company was required to assume all of these lease obligations, we estimate that the Company could settle the obligations for approximately $592 million as of January 3, 2004.

During 2003, Bob's Stores and affiliates filed a voluntary petition for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code. Subsequent to the Bob's Stores filing, The TJX Companies, Inc. ("TJX") purchased substantially all of the assets of Bob's Stores. Pursuant to the terms of the purchase, a subsidiary of TJX has assumed each of the Bob's Stores leases that the Company has guaranteed. Furthermore, TJX has agreed to indemnify the Company for any liability the Company incurs or suffers in respect of lease obligations during the time TJX or its affiliate owns and operates these store locations.

In early 2004, KB Toys, Inc. and affiliates ("Kay-Bee Toys") and Footstar, Inc. and affiliates ("Footstar") each filed a voluntary petition for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code. Due to the preliminary nature of the Kay-Bee Toys and the Footstar proceedings, the Company is unable to determine at this time the potential liability the Company may have under the Kay-Bee Toys and Footstar leases it has guaranteed. However, the Company believes that any potential liability with respect to these lease guarantee obligations would be mitigated by the indemnification the Company received from Consolidated Stores Corporation (now known as Big Lots, Inc.) as purchaser of Kay-Bee Toys from the Company, and from Footstar in connection with the 1996 spin-off of Footstar from the Company.

We believe the ultimate disposition of any of the corporate level guarantees will not have a material adverse effect on the Company's consolidated financial condition, results of operations or future cash flows.

The Company issues letters of credit for insurance programs and import purchases. The fair value of the outstanding letters of credit was $72.0 million as of January 3, 2004.

CRITICAL ACCOUNTING POLICIES

We prepare our consolidated financial statements in conformity with generally accepted accounting principles, which requires management to make certain estimates and apply judgment. We base our estimates and judgments on historical experience, current trends and other factors that management believes to be important at the time the consolidated financial statements are prepared. On a regular basis, we review our accounting policies and how they are applied and disclosed in our consolidated financial statements. While we believe that the historical experience, current trends and other factors considered support the preparation of our consolidated financial statements in conformity with generally accepted accounting principles, actual results could differ from our estimates, and such differences could be material.

Our significant accounting policies are discussed in Note 1 to our consolidated financial statements. We believe the following accounting policies include a higher degree of judgment and/or complexity and, thus, are considered to be critical accounting policies. The critical accounting policies discussed below are applicable to both of our business segments. We have discussed the development and selection of our critical accounting policies with the Audit Committee of our Board of Directors and the Audit Committee has reviewed our disclosures relating to them.

Impairment of Long-Lived Assets

We evaluate the recoverability of long-lived assets, including intangible assets with finite lives, but excluding goodwill, which is tested for impairment using a separate test, annually or whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. We group and evaluate long-lived assets for impairment at the individual store level, which is the lowest level at which individual cash flows can be identified. When evaluating long-lived assets for potential impairment, we first compare the carrying amount of the asset to the individual store's estimated future cash flows (undiscounted and without interest charges). If the estimated future cash flows are less than the carrying amount of the asset, an impairment loss calculation is prepared. The impairment loss calculation compares the carrying amount of the asset to the individual store's estimated future cash flows (discounted and with interest charges). If required, an impairment loss is recorded for the portion of the asset's carrying value that exceeds the asset's estimated future cash flow (discounted and with interest charges).

Our impairment loss calculation contains uncertainty since we must use judgment to estimate each store's future sales, profitability and cash flows. When preparing these estimates, we consider each store's historical results and current operating trends and our consolidated sales, profitability and cash flow results and forecasts. These estimates can be affected by a number of factors including, but not limited to, general economic conditions, the cost of real estate, the continued efforts of third party organizations to reduce their prescription drug costs, the continued efforts of competitors to gain market share and consumer spending patterns. Effective for fiscal 2002, we adopted SFAS No. 144, "Accounting for Impairment or Disposal of Long-Lived Assets." The adoption did not have a material impact on our impairment loss methodology and we have not made any other material changes to our impairment loss assessment methodology during the past three years.

Closed Store Lease Liability

We account for closed store lease termination costs in accordance with SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." As such, when a leased store is closed, we record a liability for the estimated present value of the remaining obligation under the noncancelable lease, which includes future real estate taxes, common area maintenance and other charges, if applicable. The liability is reduced by estimated future sublease income.

The calculation of our closed store lease liability contains uncertainty since we must use judgment to estimate the timing and duration of future vacancy periods, the amount and timing of future lump sum settlement payments and the amount and timing of potential future sublease income. When estimating these potential termination costs and their related timing, we consider a number of factors, which include, but are not limited to, historical settlement experience, the owner of the property, the location and condition of the property, the terms of the underlying lease, the specific marketplace demand and general economic conditions. We have not made any material changes in the reserve methodology used to record closed store lease reserves during the past three years.

Self-Insurance Liabilities

We are self insured for certain losses related to general liability, worker's compensation and auto liability although we maintain stop loss coverage with third party insurers to limit our total liability exposure.

The estimate of our self-insurance liability contains uncertainty since we must use judgment to estimate the ultimate cost that will be incurred to settle reported claims and unreported claims for incidents incurred but not reported as of the balance sheet date. When estimating our self-insurance liability, we consider a number of factors, which include, but are not limited to, historical claim experience, demographic factors, severity factors and valuations provided by independent third-party actuaries. On a quarterly basis, we review our assumptions with our independent third party actuaries to determine that our self-insurance liability is adequate. We have not made any material changes in the accounting methodology used to establish our self-insurance liability during the past three years.

Inventory

Our inventory is stated at the lower of cost or market on a first-in, first-out basis using the retail method of accounting to determine cost of sales and inventory in our stores, and the cost method of accounting to determine inventory in our distribution centers. Under the retail method, inventory is stated at cost, which is determined by applying a cost-to-retail ratio to the ending retail value of our inventory. Since the retail value of our inventory is adjusted on a regular basis to reflect current market conditions, our carrying value should approximate the lower of cost or market. In addition, we reduce the value of our ending inventory for estimated inventory losses that have occurred during the interim period between physical inventory counts. Physical inventory counts are taken on a regular basis in each location to ensure that the amounts reflected in the consolidated financial statements are properly stated.

The accounting for inventory contains uncertainty since we must use judgment to estimate the inventory losses that have occurred during the interim period between physical inventory counts. When estimating these losses, we consider a number of factors, which include but are not limited to, historical physical inventory results on a location-by-location basis and current inventory loss trends. We have not made any material changes in the accounting methodology used to establish our inventory loss reserves during the past three years.

Although we believe that the estimates discussed above are reasonable and the related calculations conform to generally accepted accounting principles, actual results could differ from our estimates, and such differences could be material.

RECENT ACCOUNTING PRONOUNCEMENTS

We adopted Emerging Issues Task Force ("EITF") Issue No. 02-16, "Accounting by a Reseller for Cash Consideration Received from a Vendor," on a prospective basis effective December 29, 2002. This pronouncement requires vendor allowances be treated as a reduction in inventory costs unless specifically identified as a reimbursement for other services. In addition, any vendor allowances received in excess of the cost incurred for such services should also be treated as a reduction of inventory costs. The adoption of this pronouncement resulted in a $13.3 million reduction in net earnings during 2003.

We adopted SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity," effective June 15, 2003. This Statement requires certain instruments previously classified as equity on a company's consolidated balance sheet to now be classified as liabilities. The adoption of this Statement did not have a material impact on our consolidated results of operations or financial position.

We adopted SFAS No. 132, (revised 2003) "Employer's Disclosures about Pensions and Other Postretirement Benefits," effective December 15, 2003. This Statement requires disclosures in addition to those required in the original Statement 132 about the assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension plans and other defined benefit postretirement plans.

In November 2003, the EITF reached a consensus on Issue 03-10, "Application of EITF Issue No. 02-16, Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor, by Resellers to Sales Incentives Offered to Consumers by Manufacturers," effective in fiscal periods beginning after November 26, 2003. We do not expect the adoption of this Statement will have a material impact on our consolidated results of operations or financial position.

CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 (the "Reform Act") provides a safe harbor for forward-looking statements made by or on behalf of CVS Corporation. The Company and its representatives may, from time to time, make written or verbal forward-looking statements, including statements contained in the Company's filings with the Securities and Exchange Commission and in its reports to stockholders. Generally, the inclusion of the words "believe," "expect," "intend," "estimate," "project," "anticipate," "will" and similar expressions identify statements that constitute forward-looking statements. All statements addressing operating performance of CVS Corporation or any subsidiary, events or developments that the Company expects or anticipates will occur in the future, including statements relating to sales growth, earnings or earnings per common share growth, free cash flow, debt rating, inventory levels, inventory turn and loss rates, store development, relocations and new market entries, as well as statements expressing optimism or pessimism about future operating results or events, are forward-looking statements within the meaning of the Reform Act. The forward-looking statements are and will be based upon management's then-current views and assumptions regarding future events and operating performance, and are applicable only as of the dates of such statements. The Company undertakes no obligation to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise. By their nature, all forward-looking statements involve risks and uncertainties. Actual results may differ materially from those contemplated by the forward-looking statements for a number of reasons, including, but not limited to:

— The continued efforts of health maintenance organizations, managed care organizations, pharmacy benefit management companies, governmental entities and other third party payors to reduce prescription drug costs and pharmacy reimbursement rates;
— The growth of mail order pharmacies and changes to pharmacy benefit plans requiring maintenance medications to be filled exclusively through mail order pharmacies;
— Increased competition from other drugstore chains, supermarkets, discount retailers, membership clubs, and internet companies as well as changes in consumer preferences or loyalties;
— The frequency and rate of introduction of successful new prescription drugs;
— Our ability to generate sufficient cash flows to support capital expansion and general operating activities;
— Interest rate fluctuations and changes in capital market conditions or other events affecting our ability to obtain necessary financing on favorable terms;
— Our ability to identify, implement and successfully manage and finance strategic expansion opportunities including entering new markets, acquisitions and joint ventures;
— Our ability to establish effective advertising, marketing and promotional programs (including pricing strategies and price reduction programs implemented in response to competitive pressures and/or to drive demand);
— Our ability to continue to secure suitable new store locations under acceptable lease terms;
— Our ability to attract, hire and retain suitable pharmacists and management personnel;
— Our ability to achieve cost efficiencies and other benefits from various operational initiatives and technological enhancements;
— Litigation risks as well as changes in laws and regulations, including changes in accounting standards and taxation requirements (including tax rate changes, new tax laws and revised tax law interpretations);
— The creditworthiness of the purchasers of businesses formerly owned by CVS and whose leases are guaranteed by CVS;
— Fluctuations in inventory cost, availability and loss levels and our ability to maintain relationships with suppliers on favorable terms;
— Our ability to implement successfully and to manage new computer systems and technologies;
— The strength of the economy in general or in the markets served by CVS, including changes in consumer purchasing power and/or spending patterns; and
— Other risks and uncertainties detailed from time to time in our filings with the Securities and Exchange Commission.

The foregoing list is not exhaustive. There can be no assurance that the Company has correctly identified and appropriately assessed all factors affecting its business. Additional risks and uncertainties not presently known to the Company or that it currently believes to be immaterial also may adversely impact the Company. Should any risks and uncertainties develop into actual events, these developments could have material adverse effects on the Company's business, financial condition and results of operations. For these reasons, you are cautioned not to place undue reliance on the Company's forward-looking statements.

Consolidated Statements of Operations

In millions, except per share amounts	FISCAL YEAR ENDED JAN. 3, 2004 (53 WEEKS)	DEC. 28, 2002 (52 WEEKS)	DEC. 29, 2001 (52 WEEKS)
Net sales	**$ 26,588.0**	$ 24,181.5	$ 22,241.4
Cost of goods sold, buying and warehousing costs	**19,725.0**	18,112.7	16,550.4
Gross margin	**6,863.0**	6,068.8	5,691.0
Selling, general and administrative expenses	**5,097.7**	4,552.3	4,599.6
Depreciation and amortization	**341.7**	310.3	320.8
Total operating expenses	**5,439.4**	4,862.6	4,920.4
Operating profit	**1,423.6**	1,206.2	770.6
Interest expense, net	**48.1**	50.4	61.0
Earnings before income tax provision	**1,375.5**	1,155.8	709.6
Income tax provision	**528.2**	439.2	296.4
Net earnings	**847.3**	716.6	413.2
Preference dividends, net of income tax benefit	**14.6**	14.8	14.7
Net earnings available to common shareholders	**$ 832.7**	$ 701.8	$ 398.5
BASIC EARNINGS PER COMMON SHARE:			
Net earnings	**$ 2.11**	$ 1.79	$ 1.02
Weighted average common shares outstanding	**394.4**	392.3	392.2
DILUTED EARNINGS PER COMMON SHARE:			
Net earnings	**$ 2.06**	$ 1.75	$ 1.00
Weighted average common shares outstanding	**407.7**	405.3	408.3
DIVIDENDS DECLARED PER COMMON SHARE	**$ 0.230**	$ 0.230	$ 0.230

See accompanying notes to consolidated financial statements.

Consolidated Balance Sheets

In millions, except shares and per share amounts	*JAN. 3, 2004*	*DEC. 28, 2002*
ASSETS:		
Cash and cash equivalents	**$ 843.2**	$ 700.4
Accounts receivable, net	**1,349.6**	1,019.3
Inventories	**4,016.5**	4,013.9
Deferred income taxes	**252.1**	216.4
Other current assets	**35.1**	32.1
TOTAL CURRENT ASSETS	**6,496.5**	5,982.1
Property and equipment, net	**2,542.1**	2,215.8
Goodwill	**889.0**	878.9
Intangible assets, net	**403.7**	351.4
Deferred income taxes	**—**	6.6
Other assets	**211.8**	210.5
TOTAL ASSETS	**$ 10,543.1**	$ 9,645.3
LIABILITIES:		
Accounts payable	**$ 1,666.4**	$ 1,707.9
Accrued expenses	**1,499.6**	1,361.2
Short-term debt	**—**	4.8
Current portion of long-term debt	**323.2**	32.0
TOTAL CURRENT LIABILITIES	**3,489.2**	3,105.9
Long-term debt	**753.1**	1,076.3
Deferred income taxes	**41.6**	—
Other long-term liabilities	**237.4**	266.1
Commitments and contingencies (Note 9)		
SHAREHOLDERS' EQUITY:		
Preferred stock, $0.01 par value: authorized 120,619 shares; no shares issued or outstanding	**—**	—
Preference stock, series one ESOP convertible, par value $1.00: authorized 50,000,000 shares; issued and outstanding 4,541,000 shares at January 3, 2004 and 4,685,000 shares at December 28, 2002	**242.7**	250.4
Common stock, par value $0.01: authorized 1,000,000,000 shares; issued 410,187,000 shares at January 3, 2004 and 409,286,000 shares at December 28, 2002	**4.1**	4.1
Treasury stock, at cost: 14,803,000 shares at January 3, 2004 and 16,215,000 shares at December 28, 2002	**(428.6)**	(469.5)
Guaranteed ESOP obligation	**(163.2)**	(194.4)
Capital surplus	**1,557.2**	1,546.6
Retained earnings	**4,846.5**	4,104.4
Accumulated other comprehensive loss	**(36.9)**	(44.6)
TOTAL SHAREHOLDERS' EQUITY	**6,021.8**	5,197.0
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**$ 10,543.1**	$ 9,645.3

See accompanying notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

In millions	SHARES			DOLLARS		
	JAN. 3, 2004	DEC. 28, 2002	DEC. 29, 2001	JAN. 3, 2004	DEC. 28, 2002	DEC. 29, 2001
PREFERENCE STOCK:						
Beginning of year	**4.7**	4.9	5.0	**$ 250.4**	$ 261.2	$ 267.5
Conversion to common stock	**(0.2)**	(0.2)	(0.1)	**(7.7)**	(10.8)	(6.3)
End of year	**4.5**	4.7	4.9	**242.7**	250.4	261.2
COMMON STOCK:						
Beginning of year	**409.3**	408.5	407.4	**4.1**	4.1	4.1
Stock options exercised and awards	**0.9**	0.8	1.1	**—**	—	—
End of year	**410.2**	409.3	408.5	**4.1**	4.1	4.1
TREASURY STOCK:						
Beginning of year	**(16.2)**	(17.6)	(15.1)	**(469.5)**	(510.8)	(404.9)
Purchase of treasury shares	**—**	—	(3.4)	**(0.5)**	—	(129.0)
Conversion of preference stock	**0.3**	0.5	0.3	**9.6**	13.5	7.5
Employee stock purchase plan issuance	**1.1**	0.9	0.6	**31.8**	27.8	15.6
End of year	**(14.8)**	(16.2)	(17.6)	**(428.6)**	(469.5)	(510.8)
GUARANTEED ESOP OBLIGATION:						
Beginning of year				**(194.4)**	(219.9)	(240.6)
Reduction of guaranteed ESOP obligation				**31.2**	25.5	20.7
End of year				**(163.2)**	(194.4)	(219.9)
CAPITAL SURPLUS:						
Beginning of year				**1,546.6**	1,539.6	1,493.8
Conversion of preference stock				**(1.9)**	(2.7)	(1.2)
Stock option activity and awards				**9.2**	6.7	33.9
Tax benefit on stock options and awards				**3.3**	3.0	13.1
End of year				**1,557.2**	1,546.6	1,539.6
ACCUMULATED OTHER COMPREHENSIVE LOSS:						
Beginning of year				**(44.6)**	—	—
Minimum pension liability adjustment				**7.7**	(44.6)	—
End of year				**(36.9)**	(44.6)	—
RETAINED EARNINGS:						
Beginning of year				**4,104.4**	3,492.7	3,184.7
Net earnings				**847.3**	716.6	413.2
Preference stock dividends				**(17.7)**	(18.3)	(19.1)
Tax benefit on preference stock dividends				**3.1**	3.5	4.4
Common stock dividends				**(90.6)**	(90.1)	(90.5)
End of year				**4,846.5**	4,104.4	3,492.7
TOTAL SHAREHOLDERS' EQUITY				**$ 6,021.8**	$ 5,197.0	$ 4,566.9
COMPREHENSIVE INCOME:						
Net earnings				**$ 847.3**	$ 716.6	$ 413.2
Minimum pension liability, net of income tax				**7.7**	(44.6)	—
Comprehensive income				**$ 855.0**	$ 672.0	$ 413.2

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

In millions	FISCAL YEAR ENDED *JAN. 3, 2004 (53 WEEKS)*	*DEC. 28, 2002 (52 WEEKS)*	*DEC. 29, 2001 (52 WEEKS)*
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net earnings	**$ 847.3**	$ 716.6	$ 413.2
Adjustments required to reconcile net earnings to net cash provided by operating activities:			
Restructuring charge	**—**	—	352.5
Depreciation and amortization	**341.7**	310.3	320.8
Deferred income taxes and other noncash items	**41.1**	71.8	(83.5)
Change in operating assets and liabilities providing/(requiring) cash, net of effects from acquisitions:			
Accounts receivable, net	**(311.1)**	(53.1)	(141.7)
Inventories	**2.1**	(95.3)	(366.8)
Other current assets	**(3.0)**	12.5	4.1
Other assets	**(0.4)**	(35.3)	(13.9)
Accounts payable	**(41.5)**	172.0	184.4
Accrued expenses	**116.5**	105.0	11.6
Other long-term liabilities	**(23.8)**	0.3	(0.1)
NET CASH PROVIDED BY OPERATING ACTIVITIES	**968.9**	1,204.8	680.6
CASH FLOWS FROM INVESTING ACTIVITIES:			
Additions to property and equipment	**(1,121.7)**	(1,108.8)	(713.6)
Proceeds from sale-leaseback transactions	**487.8**	448.8	323.3
Acquisitions, net of cash and investments	**(133.1)**	(93.5)	(159.1)
Proceeds from sale or disposal of assets	**13.4**	17.7	12.6
NET CASH USED IN INVESTING ACTIVITIES	**(753.6)**	(735.8)	(536.8)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Reductions in long-term debt	**(0.8)**	(3.1)	(1.0)
Additions to long-term debt	**—**	300.0	296.9
Proceeds from exercise of stock options	**38.3**	34.0	47.3
Dividends paid	**(105.2)**	(104.9)	(105.2)
Purchase of treasury shares	**—**	—	(129.0)
Reductions in short-term borrowings	**(4.8)**	(230.9)	(353.8)
NET CASH USED IN FINANCING ACTIVITIES	**(72.5)**	(4.9)	(244.8)
Net increase (decrease) in cash and cash equivalents	**142.8**	464.1	(101.0)
Cash and cash equivalents at beginning of year	**700.4**	236.3	337.3
CASH AND CASH EQUIVALENTS AT END OF YEAR	**$ 843.2**	$ 700.4	$ 236.3

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

1—SIGNIFICANT ACCOUNTING POLICIES

Description of business ~ CVS Corporation (the "Company") is a leader in the retail drugstore industry in the United States. The Company sells prescription drugs and a wide assortment of general merchandise, including over-the-counter drugs, greeting cards, film and photofinishing services, beauty products and cosmetics, seasonal merchandise and convenience foods, through its CVS/pharmacy® stores and online through CVS.com®. The Company also provides Pharmacy Benefit Management and Specialty Pharmacy services through PharmaCare Management Services. As of January 3, 2004, the Company operated 4,179 retail and specialty pharmacy stores in 32 states and the District of Columbia. See Note 10 for further information about the Company's business segments.

Basis of presentation ~ The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All material intercompany balances and transactions have been eliminated.

Fiscal Year ~ The Company's fiscal year is a 52 or 53 week period ending on the Saturday nearest to December 31. Fiscal 2003, which ended on January 3, 2004, included 53 weeks, while fiscal years 2002 and 2001 which ended on December 28, 2002 and December 29, 2001, respectively, included 52 weeks. Unless otherwise noted, all references to years relate to the Company's fiscal year.

Reclassifications ~ Certain reclassifications have been made to the consolidated financial statements of prior years to conform to the current year presentation.

Use of estimates ~ The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and cash equivalents ~ Cash and cash equivalents consist of cash and temporary investments with maturities of three months or less when purchased.

Accounts receivable ~ Accounts receivable are stated net of an allowance for uncollectible accounts of $58.4 million and $64.2 million as of January 3, 2004 and December 28, 2002, respectively. The balance primarily includes amounts due from third party providers (e.g., pharmacy benefit managers, insurance companies and governmental agencies) and vendors.

Fair value of financial instruments ~ As of January 3, 2004, the Company's financial instruments include cash and cash equivalents, accounts receivable, accounts payable and debt. Due to the short-term nature of these instruments, the Company's carrying value approximates fair value. The carrying amount of long-term debt was $1.1 billion and the estimated fair value was $1.1 billion as of January 3, 2004 and December 28, 2002. The fair value of long-term debt was estimated based on rates currently offered to the Company for debt with similar maturities. The Company also had outstanding letters of credit, which guaranteed foreign trade purchases, with a fair value of $6.5 million as of January 3, 2004, and $5.8 million as of December 28, 2002. The Company also has outstanding letters of credit associated with insurance programs with a fair value of $65.5 million as of January 3, 2004 and $53.1 million as of December 28, 2002. There were no investments in derivative financial instruments as of January 3, 2004 or December 28, 2002.

Inventories ~ Inventory is stated at the lower of cost or market on a first-in, first-out basis using the retail method of accounting to determine cost of sales and inventory in our stores and the cost method of accounting to determine inventory in our distribution centers. Independent physical inventory counts are taken on a regular basis in each store and distribution center location to ensure that the amounts reflected in the accompanying consolidated financial statements are properly stated. During the interim period between physical inventory counts, the Company accrues for anticipated physical inventory losses on a location-by-location basis based on historical results and current trends.

Property and equipment ~ Property, equipment and improvements to leased premises are depreciated using the straight-line method over the estimated useful lives of the assets, or when applicable, the term of the lease, whichever is shorter. Estimated useful lives generally range from 10 to 40 years for buildings, building improvements and leasehold improvements and 5 to 10 years for fixtures and equipment. Repair and maintenance costs are charged directly to expense as incurred. Major renewals or replacements that substantially extend the useful life of an asset are capitalized and depreciated.

Following are the components of property and equipment included in the consolidated balance sheets as of the respective balance sheet dates:

In millions	*JAN. 3, 2004*	*DEC. 28, 2002*
Land	**$ 180.7**	$ 132.3
Building and improvements	**492.8**	479.2
Fixtures and equipment	**2,123.3**	1,769.3
Leasehold improvements	**1,012.8**	899.0
Capitalized software	**149.5**	124.5
Capital leases	**1.3**	1.3
	3,960.4	3,405.6
Accumulated depreciation and amortization	**(1,418.3)**	(1,189.8)
	$ 2,542.1	$ 2,215.8

In accordance with Statement of Position No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use," the Company capitalizes application stage development costs for significant internally developed software projects. These costs are amortized over a 5-year period. Unamortized costs were $90.6 million as of January 3, 2004 and $89.5 million as of December 28, 2002.

Impairment of long-lived assets ~ The Company groups and evaluates fixed and intangible assets excluding goodwill, for impairment at the individual store level, which is the lowest level at which individual cash flows can be identified. When evaluating assets for potential impairment, the Company first compares the carrying amount of the asset to the asset's estimated future cash flows (undiscounted and without interest charges). If the estimated future cash flows used in this analysis are less than the carrying amount of the asset, an impairment loss calculation is prepared. The impairment loss calculation compares the carrying amount of the asset to the asset's estimated future cash flows (discounted and with interest charges). If the carrying amount exceeds the asset's estimated future cash flows (discounted and with interest charges), the loss is allocated to the long-lived assets of the group on a pro rata basis using the relative carrying amounts of those assets.

Intangible assets ~ Purchased customer lists are amortized on a straight-line basis over their estimated useful lives of up to 10 years. Purchased leases are amortized on a straight-line basis over the remaining life of the lease. See Note 4 for further information on intangible assets.

Revenue recognition ~ The Company recognizes revenue from the sale of merchandise at the time the merchandise is sold. Service revenue from the Company's pharmacy benefit management segment, which is recognized using the net method under Emerging Issues Task Force ("EITF") No. 99-19, "Reporting Revenue Gross as a Principal Versus Net as an Agent," is recognized at the time the service is provided. Service revenue totaled $96.0 million in 2003, $84.9 million in 2002 and $82.1 million in 2001. The Company offers sales incentives that entitle customers to receive a reduction in the price of a product or service. For sales incentives in which the Company is the obligor, the reduction in revenue is recognized at the time the product or service is sold. Customer returns are immaterial.

Vendor allowances ~ The Company accounts for vendor allowances under the guidance provided by EITF No. 02-16, "Accounting by a Reseller for Cash Consideration Received from a Vendor." Vendor allowances reduce the carrying cost of inventory unless they are specifically identified as a reimbursement for promotional programs and/or other services provided. Funds that are directly linked to advertising commitments are recognized as a reduction of advertising expense in the selling, general and administrative expenses line when the related advertising commitment is satisfied. Any such allowances received in excess of the actual cost incurred also reduce the carrying cost of inventory. The total value of any upfront payments received from vendors that are linked to purchase commitments is initially deferred. The deferred amounts are then amortized to reduce cost of goods sold over the life of the contract based upon purchase volume. The total value of any upfront payments received from vendors that are not linked to purchase commitments is also initially deferred. The deferred amounts are then amortized to reduce cost of goods sold on a straight-line basis over the life of the related contract. The total amortization of these upfront payments was not material to the accompanying consolidated financial statements.

Store opening and closing costs ~ New store opening costs, other than capital expenditures, are charged directly to expense when incurred. When the Company closes a store, the present value of estimated unrecoverable costs, including the remaining lease obligation less estimated sublease income and the book value of abandoned property and equipment, are charged to expense.

Insurance ~ The Company is self-insured for certain losses related to general liability, workers' compensation and automobile liability. The Company obtains third party insurance coverage to limit exposure from these claims. The Company's self-insurance accruals, which include reported claims and claims incurred but not reported, are calculated using standard insurance industry actuarial assumptions and the Company's historical claims experience.

Stock-based compensation ~ The Company accounts for its stock-based compensation plans under the recognition and measurement principles of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. As such, no stock-based employee compensation cost is reflected in net earnings for options granted under those plans since they had an exercise price equal to the market value of the underlying common stock on the date of grant. See Note 7 for further information on stock-based compensation. The following table summarizes the effect on net earnings and earnings per common share if the company had applied the fair value recognition provisions of Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation," to stock-based employee compensation for the respective years:

In millions, except per share amounts		*2003*	*2002*	*2001*
Net earnings, as reported		**$ 847.3**	$ 716.6	$ 413.2
Add: Stock-based employee compensation expense included in reported net earnings, net of related tax effects[1]		**2.2**	2.7	3.3
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects		**52.4**	56.8	59.4
Pro forma net earnings		**$ 797.1**	$ 662.5	$ 357.1
Basic EPS:	As reported	**$ 2.11**	$ 1.79	$ 1.02
	Pro forma	**1.98**	1.65	0.87
Diluted EPS:	As reported	**$ 2.06**	$ 1.75	$ 1.00
	Pro forma	**1.95**	1.62	0.86

(1) Amounts represent the after-tax compensation costs for restricted stock grants.

Advertising costs ~ Advertising costs are expensed when the related advertising takes place. Advertising costs, net of vendor funding, which is included in selling, general and administrative expenses, were $178.2 million in 2003, $152.2 million in 2002 and $126.9 million in 2001.

Interest expense, net ~ Interest expense was $53.9 million, $54.5 million and $65.2 million and interest income was $5.8 million, $4.1 million and $4.2 million in 2003, 2002 and 2001, respectively. Capitalized interest totaled $11.0 million in 2003, $6.1 million in 2002 and $10.1 million in 2001. Interest paid totaled $64.9 million in 2003, $60.7 million in 2002 and $75.2 million in 2001.

Nonrecurring items ~ During 2001, the Company received $50.3 million of settlement proceeds from various lawsuits against certain manufacturers of brand name prescription drugs. The Company elected to contribute $46.8 million of the settlement proceeds to the CVS Charitable Trust, Inc. The net effect of the two nonrecurring items was a $3.5 million pre-tax ($2.1 million after-tax) increase in net earnings (the "Net Litigation Gain"). The Company also recorded a $352.5 million pre-tax ($230.5 million after-tax) restructuring and asset impairment charge in connection with the 2001 strategic restructuring, which resulted from a comprehensive business review designed to streamline operations and enhance operating efficiencies. See Note 11 for further information on the 2001 strategic restructuring and resulting charge.

Income taxes ~ The Company provides for federal and state income taxes currently payable, as well as for those deferred because of timing differences between reporting income and expenses for financial statement purposes versus tax purposes. Federal and state incentive tax credits are recorded as a reduction of income taxes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recoverable or settled. The effect of a change in tax rates is recognized as income or expense in the period of the change.

Accumulated other comprehensive loss ~ Accumulated other comprehensive loss consists of a $36.9 million and $44.6 million minimum pension liability, net of a $22.5 and $27.3 million income tax benefit, as of January 3, 2004 and December 28, 2002, respectively. There was no accumulated other comprehensive income or loss as of December 29, 2001.

Earnings per common share ~ Basic earnings per common share is computed by dividing: (i) net earnings, after deducting the after-tax ESOP preference dividends, by (ii) the weighted average number of common shares

outstanding during the year (the "Basic Shares"). When computing diluted earnings per common share, the Company assumes that the ESOP preference stock is converted into common stock and all dilutive stock options are exercised. After the assumed ESOP preference stock conversion, the ESOP trust would hold common stock rather than ESOP preference stock and would receive common stock dividends (currently $0.23 per share) rather than ESOP preference stock dividends (currently $3.90 per share). Since the ESOP Trust uses the dividends it receives to service its debt, the Company would have to increase its contribution to the ESOP trust to compensate it for the lower dividends. This additional contribution would reduce the Company's net earnings, which in turn, would reduce the amounts that would be accrued under the Company's incentive compensation plans.

Diluted earnings per common share is computed by dividing: (i) net earnings, after accounting for the difference between the dividends on the ESOP preference stock and common stock and after making adjustments for the incentive compensation plans by (ii) Basic Shares plus the additional shares that would be issued assuming that all dilutive stock options are exercised and the ESOP preference stock is converted into common stock. Options to purchase 18.5 million and 20.0 million shares of common stock were outstanding as of January 3, 2004 and December 28, 2002, respectively, but were not included in the calculation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common shares and, therefore, the effect would be antidilutive.

New Accounting Pronouncements ~ The Company adopted SFAS No. 143, "Accounting for Asset Retirement Obligations," effective December 29, 2002. This statement applies to legal obligations associated with the retirement of certain tangible long-lived assets. The adoption of this Statement did not have a material impact on the Company's consolidated results of operations or financial position.

The Company adopted SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections," effective December 29, 2002. This statement (i) eliminates extraordinary accounting treatment for a gain or loss reported on the extinguishment of debt, (ii) eliminates inconsistencies in the accounting required for sale-leaseback transactions and certain lease modifications with similar economic effects and (iii) amends other existing authoritative pronouncements to make technical corrections, clarify meanings or describe their applicability under changed conditions. The adoption of this Statement did not have a material impact on the Company's consolidated results of operations or financial position.

The Company adopted SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," effective December 29, 2002. This Statement nullifies existing guidance related to the accounting and reporting for costs associated with exit or disposal activities and requires that the fair value of a liability associated with an exit or disposal activity be recognized when the liability is incurred. Under previous guidance, certain exit costs were permitted to be accrued upon management's commitment to an exit plan, which is generally before an actual liability has been incurred. The adoption of this Statement did not have a material impact on the Company's consolidated results of operations or financial position.

The Company adopted Emerging Issues Task Force Issue No. 02-16, "Accounting by a Reseller for Cash Consideration Received from a Vendor," on a prospective basis effective December 29, 2002. This pronouncement requires vendor allowances be treated as a reduction in inventory costs unless specifically identified as a reimbursement for other services. In addition, any vendor allowances received in excess of the cost incurred for such services should also be treated as a reduction of inventory costs. The adoption of this pronouncement resulted in a $13.3 million reduction in net earnings during 2003.

The Company adopted FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," effective December 29, 2002. This interpretation requires certain guarantees to be recorded at fair value as opposed to the current practice of recording a liability only when a loss is probable and reasonably estimable. It also requires a guarantor to make enhanced disclosures concerning guarantees, even when the likelihood of making any payments under the guarantee is remote. The adoption of this Statement did not have a material impact on the Company's consolidated results of operations or financial position.

The Company adopted FASB Interpretation No. 46, "Consolidation of Variable Interest Entities," effective December 29, 2002. This interpretation requires a company to consolidate variable interest entities ("VIE") if the enterprise is a primary beneficiary (holds a majority of the variable interest) of the VIE and the VIE possesses specific characteristics. It also requires additional disclosures for parties involved with VIEs. The adoption of this Statement did not have a material impact on the Company's consolidated results of operations or financial position.

The Company adopted FASB Interpretation No. ("FIN") 46, (revised December 2003), "Consolidation of Variable Interest Entities," effective December 24, 2003. This interpretation addresses how a business should evaluate controlling financial interest in an entity. FIN 46R replaces FASB Interpretation No. 46. The adoption of this Statement did not have a material impact on the Company's consolidated results of operations or financial position.

The Company adopted SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity," effective June 15, 2003. This Statement requires certain instruments previously classified as equity on a company's statement of financial position now be classified as liabilities. The adoption of this Statement did not have a material impact on the Company's consolidated results of operations or financial position.

The Company adopted SFAS No. 132, (revised 2003), "Employer's Disclosures about Pensions and Other Postretirement Benefits," effective December 15, 2003. This Statement requires additional disclosures to those in the original Statement 132 about the assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension plans and other defined benefit postretirement plans. The adoption of this Statement did not have a material impact on the Company's consolidated results of operations or financial position.

2—LEASES

The Company leases most of its retail locations and five of its distribution centers under noncancelable operating leases, whose initial terms typically range from 15 to 25 years, along with options that permit renewals for additional periods. The Company also leases certain equipment and other assets under noncancelable operating leases, whose initial terms typically range from 3 to 10 years. Minimum rent is expensed on a straight-line basis over the term of the lease. In addition to minimum rental payments, certain leases require additional payments based on sales volume, as well as reimbursements for real estate taxes, maintenance and insurance.

Following is a summary of the Company's net rental expense for operating leases for the respective years:

In millions	*2003*	*2002*	*2001*
Minimum rentals	**$ 838.4**	$ 790.4	$ 758.2
Contingent rentals	**62.0**	65.6	67.6
	900.4	856.0	825.8
Less: sublease income	**(10.1)**	(9.3)	(9.1)
	$ 890.3	$ 846.7	$ 816.7

Following is a summary of the future minimum lease payments under capital and operating leases as of January 3, 2004:

In millions	*CAPITAL LEASES*	*OPERATING LEASES*
2004	$ 0.2	$ 855.9
2005	0.2	816.3
2006	0.2	757.7
2007	0.2	704.5
2008	0.2	661.6
Thereafter	0.3	6,992.9
	1.3	$ 10,788.9
Less: imputed interest	(0.4)	
Present value of capital lease obligations	$ 0.9	

The Company finances a portion of its store development program through sale-leaseback transactions. The properties are sold at net book value and the resulting leases qualify and are accounted for as operating leases. The Company does not have any retained or contingent interests in the stores nor does the Company provide any guarantees, other than a corporate level guarantee of lease payments, in connection with the sale-leasebacks. Proceeds from sale-leaseback transactions totaled $487.8 million in 2003, $448.8 million in 2002 and $323.3 million in 2001. During 2001, the Company completed a sale-leaseback transaction involving five of its distribution centers. The distribution centers were sold at fair market value resulting in a $35.5 million gain, which was deferred and is being amortized to offset rent expense over the life of the new operating leases. The operating leases that resulted from these transactions are included in the above table.

3—BORROWING AND CREDIT AGREEMENTS

Following is a summary of the Company's borrowings as of the respective balance sheet dates:

In millions	*JAN. 3, 2004*	*DEC. 28, 2002*
Commercial paper	**$ —**	$ 4.8
5.5% senior notes due 2004	**300.0**	300.0
5.625% senior notes due 2006	**300.0**	300.0
3.875% senior notes due 2007	**300.0**	300.0
8.52% ESOP notes due 2008[1]	**163.2**	194.4
Mortgage notes payable	**12.2**	13.0
Capital lease obligations	**0.9**	0.9
	1,076.3	1,113.1
Less:		
Short-term debt	**—**	(4.8)
Current portion of long-term debt	**(323.2)**	(32.0)
	$ 753.1	$ 1,076.3

(1) See Note 5 for further information about the Company's ESOP Plan.

In connection with our commercial paper program, the Company maintains a $650 million, five-year unsecured back-up credit facility, which expires on May 21, 2006 and a $600 million, 364-day unsecured back-up credit facility, which expires on May 17, 2004. The credit facilities allow for borrowings at various rates depending on the Company's public debt ratings and require the Company to pay a quarterly facility fee of 0.08%, regardless of usage. As of January 3, 2004, the Company had not borrowed against the credit facilities. There was no short-term debt outstanding as of January 3, 2004. The weighted average interest rate for short-term debt was 1.9% as of December 28, 2002.

In October 2002, the Company issued $300 million of 3.875% unsecured senior notes. The notes are due November 1, 2007, and pay interest semi-annually. The Company may redeem these notes at any time, in whole or in part, at a defined redemption price plus accrued interest. Net proceeds from the notes were used to repay outstanding commercial paper.

The Credit Facilities and unsecured senior notes contain customary restrictive financial and operating covenants. The covenants do not materially affect the Company's financial or operating flexibility.

The aggregate maturities of long-term debt for each of the five years subsequent to January 3, 2004 are $323.2 million in 2004, $27.9 million in 2005, $334.4 million in 2006, $341.7 million in 2007 and $45.8 million in 2008.

4—GOODWILL AND OTHER INTANGIBLES

Goodwill represents the excess of the purchase price over the fair value of net assets acquired. Effective December 30, 2001, the Company adopted SFAS No. 142, "Goodwill and Other Intangible Assets." As a result of the adoption, goodwill is no longer being amortized, but is subject to annual impairment reviews, or more frequent reviews if events or circumstances indicate there may be an impairment. The Company groups and evaluates goodwill for impairment at the reporting unit level annually, or whenever events or circumstances indicate there may be an impairment. When evaluating goodwill for potential impairment, the Company first compares the fair value of the reporting unit, based on estimated future discounted cash flows, with its carrying amount. If the estimated fair value of the reporting unit is less than its carrying amount, an impairment loss calculation is prepared. The impairment loss calculation compares the implied fair value of reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount of reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. During the third quarter of 2003, the Company performed its required annual goodwill impairment test, which concluded there was no impairment of goodwill.

The following summary details the after-tax impact, on a pro forma basis, of discontinuing the amortization of goodwill on net earnings and earnings per common share ("EPS") for the respective years:

In millions, except per share amounts	*2003*	*2002*	*2001*
Net Earnings:			
As reported	**$ 847.3**	$ 716.6	$ 413.2
Goodwill amortization	**—**	—	28.2
As adjusted	**847.3**	716.6	441.4
Basic EPS:			
As reported	**$ 2.11**	$ 1.79	$ 1.02
Goodwill amortization	**—**	—	0.07
As adjusted	**2.11**	1.79	1.09
Diluted EPS:			
As reported	**$ 2.06**	$ 1.75	$ 1.00
Goodwill amortization	**—**	—	0.07
As adjusted	**2.06**	1.75	1.07

The carrying amount of goodwill was $889.0 million and $878.9 million as of January 3, 2004 and December 28, 2002, respectively. During 2003, gross goodwill increased $10.1 million, primarily due to acquisitions by the Company's PBM segment. There was no impairment of goodwill during 2003.

Intangible assets other than goodwill are required to be separated into two categories: finite-lived and indefinite-lived. Intangible assets with finite useful lives are amortized over their estimated useful life, while intangible assets with indefinite useful lives are not amortized. The Company currently has no intangible assets with indefinite lives.

Following is a summary of the Company's amortizable intangible assets as of the respective balance sheet dates:

	JAN. 3, 2004		DEC. 28, 2002	
In millions	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION
Customer lists and Covenants not to compete[1]	**$ 571.3**	**$ (241.4)**	$ 464.5	$ (194.1)
Favorable leases and Other[2]	**152.3**	**(78.5)**	153.1	(72.1)
	$ 723.6	**$ (319.9)**	$ 617.6	$ (266.2)

(1) The increase in the gross carrying amount during 2003 was primarily due to the acquisition of customer lists.
(2) The decrease in the gross carrying amount during 2003 resulted from the write-off of fully amortized favorable leases.

The amortization expense for these intangible assets totaled $63.2 million in 2003, $53.3 million in 2002 and $52.7 million in 2001. The anticipated annual amortization expense for these intangible assets is $66.7 million in 2004, $59.6 million in 2005, $54.5 million in 2006, $49.0 million in 2007 and $45.0 million in 2008.

5—EMPLOYEE STOCK OWNERSHIP PLAN

The Company sponsors a defined contribution Employee Stock Ownership Plan (the "ESOP") that covers full-time employees with at least one year of service.

In 1989, the ESOP Trust issued and sold $357.5 million of 20-year, 8.52% notes due December 31, 2008 (the "ESOP Notes"). The proceeds from the ESOP Notes were used to purchase 6.7 million shares of Series One ESOP Convertible Preference Stock (the "ESOP Preference Stock") from the Company. Since the ESOP Notes are guaranteed by the Company, the outstanding balance is reflected as long-term debt and a corresponding guaranteed ESOP obligation is reflected in shareholders' equity in the accompanying consolidated balance sheets.

Each share of ESOP Preference Stock has a guaranteed minimum liquidation value of $53.45, is convertible into 2.314 shares of common stock and is entitled to receive an annual dividend of $3.90 per share. The ESOP Trust uses the dividends received and contributions from the Company to repay the ESOP Notes. As the ESOP Notes are repaid, ESOP Preference Stock is allocated to participants based on (i) the ratio of each year's debt service payment to total current and future debt service payments multiplied by (ii) the number of unallocated shares of ESOP Preference Stock in the plan. As of January 3, 2004, 4.5 million shares of ESOP Preference Stock were outstanding, of which 2.7 million shares were allocated to participants and the remaining 1.8 million shares were held in the ESOP Trust for future allocations.

Annual ESOP expense recognized is equal to (i) the interest incurred on the ESOP Notes plus (ii) the higher of (a) the principal repayments or (b) the cost of the shares allocated, less (iii) the dividends paid. Similarly, the guaranteed ESOP obligation is reduced by the higher of (i) the principal payments or (ii) the cost of shares allocated.

Following is a summary of the ESOP activity for the respective years:

In millions	2003	2002	2001
ESOP expense recognized	**$ 30.1**	$ 26.0	$ 22.1
Dividends paid	**17.7**	18.3	19.1
Cash contributions	**30.1**	26.0	22.1
Interest payments	**16.6**	18.7	20.5
ESOP shares allocated	**0.4**	0.4	0.4

6—PENSION PLANS AND OTHER POSTRETIREMENT BENEFITS

Defined Contribution Plans

The Company sponsors a voluntary 401(k) Savings Plan that covers substantially all employees who meet plan eligibility requirements. The Company makes matching contributions consistent with the provisions of the plan. At the participant's option, account balances, including the Company's matching contribution, can be moved without restriction among various investment options, including the Company's common stock. The Company also maintains a nonqualified, unfunded Deferred Compensation Plan for certain key employees. This plan provides participants the opportunity to defer portions of their compensation and receive matching contributions that they would have otherwise received under the 401(k) Savings Plan if not for certain restrictions and limitations under the Internal Revenue Code. The Company's contributions under the above defined contribution plans totaled $46.9 million in 2003, $29.1 million in 2002 and $26.7 million in 2001. The Company also sponsors an Employee Stock Ownership Plan. See Note 5 for further information about this plan.

Other Postretirement Benefits

The Company provides postretirement healthcare and life insurance benefits to certain retirees who meet eligibility requirements. The Company's funding policy is generally to pay covered expenses as they are incurred. For retiree medical plan accounting, the Company reviews external data and its own historical trends for healthcare costs to determine the healthcare cost trend rates.

For measurement purposes, future healthcare costs are assumed to increase at an annual rate of 10.0%, decreasing to an annual growth rate of 5.0% in 2009 and thereafter. A one percent change in the assumed healthcare cost trend rate would change the accumulated postretirement benefit obligation by $0.7 million and the total service and interest costs by $0.1 million.

In 2003, the Medicare Prescription Drug, Improvement and Modernization Act (the "Act") was signed into law in the United States. The Company has elected to defer the accounting for the effect of the Act as permitted by FASB Staff Position No. FAS 106-1 and, therefore, the benefit obligations reported below for the Company's postretirement benefit plans do not reflect the impact of the Act. Specific authoritative guidance on the accounting for the federal subsidy related to the Act is pending and, when issued, could require the Company to change previously reported information.

Pension Plans

The Company sponsors a noncontributory defined benefit pension plan that covers certain full-time employees of Revco, D.S., Inc. who were not covered by collective bargaining agreements. On September 20, 1997, the Company suspended future benefit accruals under this plan. Benefits paid to retirees are based upon age at retirement, years of credited service and average compensation during the five-year period ending September 20, 1997. The plan is funded based on actuarial calculations and applicable federal regulations.

Pursuant to various labor agreements, the Company is also required to make contributions to certain union-administered pension and health and welfare plans that totaled $13.2 million in 2003, $12.1 million in 2002 and $11.1 million in 2001. The Company also has nonqualified supplemental executive retirement plans in place for certain key employees for whom it has purchased cost recovery variable life insurance.

The Company uses an investment strategy which emphasizes equities in order to produce higher expected returns, and in the long run, lower expense and cash contribution requirements. The pension plan assets allocation targets 70% equity and 30% fixed income.

Following is the pension plan assets allocation by major category for the respective years:

	2003	*2002*
Equity	**72%**	68%
Fixed Income	**27%**	31%
Other	**1%**	1%
	100%	100%

The equity investments primarily consist of large cap value and international value equity funds. The fixed income investments primarily consist of intermediate-term bond funds. The other category consists of cash and cash equivalents held for benefit payments.

The Company utilized a measurement date of December 31st to determine pension and other postretirement benefit measurements. Following is a summary of the net periodic pension cost for the defined benefit and other postretirement benefit plans for the respective years:

	DEFINED BENEFIT PLANS			OTHER POSTRETIREMENT BENEFITS		
In millions	*2003*	*2002*	*2001*	*2003*	*2002*	*2001*
Service cost	**$ 0.8**	$ 0.8	$ 0.5	**$ —**	$ —	$ —
Interest cost on benefit obligation	**20.5**	20.4	20.9	**0.8**	0.9	0.9
Expected return on plan assets	**(18.4)**	(19.3)	(20.2)	**—**	—	—
Amortization of net loss (gain)	**1.5**	0.1	(0.3)	**(0.1)**	(0.2)	(0.2)
Amortization of prior service cost	**0.1**	0.1	0.1	**(0.1)**	(0.1)	(0.1)
Settlement gain	**—**	—	(0.2)	**—**	—	—
Net periodic pension cost	**$ 4.5**	$ 2.1	$ 0.8	**$ 0.6**	$ 0.6	$ 0.6
ACTUARIAL ASSUMPTIONS:						
Discount rate	**6.25%**	6.50%	7.50%	**6.25%**	6.50%	7.25%
Expected return on plan assets[1]	**8.50%**	8.75%	9.25%	**—**	—	—
Rate of compensation increase	**4.00%**	4.00%	4.00%	**—**	—	—

(1) The expected long-term rate of return is determined by using the target allocation and historical returns for each asset class.

Following is a reconciliation of the benefit obligation, fair value of plan assets and funded status of the Company's defined benefit and other postretirement benefit plans as of the respective balance sheet dates:

	DEFINED BENEFIT PLANS		OTHER POSTRETIREMENT BENEFITS	
In millions	*JAN. 3, 2004*	*DEC. 28, 2002*	*JAN. 3, 2004*	*DEC. 28, 2002*
CHANGE IN BENEFIT OBLIGATION:				
Benefit obligation at beginning of year	**$ 322.8**	$ 283.1	**$ 13.8**	$ 12.9
Service cost	**0.8**	0.8	**—**	—
Interest cost	**20.5**	20.4	**0.8**	0.9
Actuarial loss (gain)	**11.0**	34.8	**(0.3)**	1.0
Benefits paid	**(16.0)**	(16.3)	**(1.0)**	(1.0)
Benefit obligation at end of year	**$ 339.1**	$ 322.8	**$ 13.3**	$ 13.8
CHANGE IN PLAN ASSETS:				
Fair value at beginning of year	**$ 186.8**	$ 218.4	**$ —**	$ —
Actual return on plan assets	**38.4**	(24.1)	**—**	—
Company contributions	**17.4**	8.8	**1.0**	1.0
Benefits paid	**(16.0)**	(16.3)	**(1.0)**	(1.0)
Fair value at end of year	**$ 226.6**	$ 186.8	**$ —**	$ —
FUNDED STATUS:				
Funded status	**$ (112.5)**	$ (136.0)	**$ (13.3)**	$ (13.8)
Unrecognized prior service cost	**0.6**	0.7	**(0.5)**	(0.6)
Unrecognized loss	**64.2**	74.7	**0.7**	0.9
Net liability recognized	**$ (47.7)**	$ (60.6)	**$ (13.1)**	$ (13.5)
AMOUNTS RECOGNIZED IN THE CONSOLIDATED BALANCE SHEET:				
Accrued benefit liability	**$ (107.1)**	$ (132.5)	**$ (13.1)**	$ (13.5)
Minimum pension liability	**59.4**	71.9	**—**	—
Net liability recognized	**$ (47.7)**	$ (60.6)	**$ (13.1)**	$ (13.5)

$17.1 million of the accrued benefit liability was included in accrued expenses, while the remaining amount was recorded in other long-term liabilities, as of January 3, 2004 and December 28, 2002. The accumulated benefit obligation for the defined benefit pension plans was $333.5 and $318.0 million at January 3, 2004 and December 28, 2002, respectively. The Company estimates it will make cash contributions to the plan during the next fiscal

year of approximately $17.5 million. Estimated future benefit payments for the defined benefit plans and other postretirement benefit plans, respectively, are $14.8 million and $1.1 million in 2004, $15.2 and $1.1 million in 2005, $15.9 million and $1.1 million in 2006, $16.7 and $1.1 million in 2007, $17.7 and $1.1 million in 2008, and $105.9 million and $4.7 million in aggregate for the following five years. The Company recorded a minimum pension liability of $59.4 million as of January 3, 2004, and $71.9 million as of December 28, 2002, as required by SFAS No. 87. A minimum pension liability is required when the accumulated benefit obligation exceeds the combined fair value of the underlying plan assets and accrued pension costs. The minimum pension liability adjustment is reflected in other long-term liabilities, long-term deferred income taxes and accumulated other comprehensive loss, included in shareholders' equity, in the consolidated balance sheet.

7—STOCK INCENTIVE PLANS

The 1997 Incentive Compensation Plan provides for the granting of up to 42.9 million shares of common stock in the form of stock options and other awards to selected officers and employees of the Company. All grants under the plan are awarded at fair market value on the date of grant. Generally, options become exercisable over a four-year period from the grant date and expire ten years after the date of grant. As of January 3, 2004, there were 16.7 million shares available for future grants. The 1997 Incentive Compensation Plan allows for up to 3.6 million restricted shares to be issued. The Company granted 213,000, 26,000 and 76,000 shares of restricted stock with a weighted average per share grant date fair value of $25.26, $31.20 and $59.98, in 2003, 2002 and 2001, respectively. The fair value of the restricted shares is expensed over the period during which the restrictions lapse. Compensation costs for restricted shares totaled $3.6 million in 2003, $4.3 million in 2002 and $5.4 million in 2001.

The 1996 Directors Stock Plan provides for the granting of up to 346,000 shares of common stock to the Company's nonemployee directors. The plan allows the nonemployee directors to elect to receive shares of common stock or stock options in lieu of cash compensation. As of January 3, 2004, there were 46,000 shares available for future grants under the plan.

Following is a summary of the stock option activity for the respective years:

	2003		2002		2001	
Shares in thousands	SHARES	WEIGHTED AVERAGE EXERCISE PRICE	SHARES	WEIGHTED AVERAGE EXERCISE PRICE	SHARES	WEIGHTED AVERAGE EXERCISE PRICE
Outstanding at beginning of year	**23,390**	**$ 36.42**	17,627	$ 39.48	14,647	$ 31.11
Granted	**6,401**	**25.21**	8,022	29.89	5,381	59.55
Exercised	**(707)**	**20.26**	(517)	18.31	(1,084)	23.13
Canceled	**(2,005)**	**35.84**	(1,742)	41.66	(1,317)	43.14
Outstanding at end of year	**27,079**	**34.22**	23,390	36.42	17,627	39.48
Exercisable at end of year	**14,870**	**$ 35.53**	8,048	$ 30.21	4,609	$ 25.09

Following is a summary of the stock options outstanding and exercisable as of January 3, 2004:

Shares in thousands	OPTIONS OUTSTANDING			OPTIONS EXERCISABLE	
RANGE OF EXERCISE PRICES	NUMBER OUTSTANDING	WEIGHTED AVERAGE REMAINING LIFE	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER EXERCISABLE	WEIGHTED AVERAGE EXERCISE PRICE
$ 1.81 to $ 15.00	248	1.9	$ 13.23	248	$ 13.23
15.01 to 25.00	2,330	2.3	18.93	2,290	18.83
25.01 to 30.00	12,752	8.3	27.69	3,569	29.87
30.01 to 35.00	3,434	6.2	31.90	2,480	31.91
35.01 to 50.00	4,335	4.6	40.64	4,224	40.67
50.01 to 61.23	3,980	6.9	60.44	2,059	60.42
Total	27,079	6.7	$ 34.22	14,870	$ 35.53

The Company applies APB Opinion No. 25 to account for its stock incentive plans. Accordingly, no compensation cost has been recognized for stock options granted. Had compensation cost been recognized based on the fair value of stock options granted consistent with SFAS No. 123, net earnings and net earnings per common share ("EPS") would approximate the pro forma amounts shown below:

In millions, except per share amounts	*2003*	*2002*	*2001*
Net earnings:			
As reported	**$ 847.3**	$ 716.6	$ 413.2
Pro forma	**797.1**	662.5	357.1
Basic EPS:			
As reported	**$ 2.11**	$ 1.79	$ 1.02
Pro forma	**1.98**	1.65	0.87
Diluted EPS:			
As reported	**$ 2.06**	$ 1.75	$ 1.00
Pro forma	**1.95**	1.62	0.86

The per share weighted average fair value of stock options granted during 2003, 2002 and 2001 was $9.01, $10.46 and $25.12, respectively.

The fair value of each stock option grant was estimated using the Black-Scholes Option Pricing Model with the following assumptions:

	2003	*2002*	*2001*
Dividend yield	**0.85%**	0.96%	0.77%
Expected volatility	**29.63%**	29.50%	29.79%
Risk-free interest rate	**3.5%**	4.0%	5.0%
Expected life	**7.0**	7.0	7.0

The 1999 Employee Stock Purchase Plan provides for the purchase of up to 7.4 million shares of common stock. Under the plan, eligible employees may purchase common stock at the end of each six-month offering period, at a purchase price equal to 85% of the lower of the fair market value on the first day or the last day of the offering period. During 2003, 1.1 million shares of common stock were purchased at an average price of $21.34 per share. As of January 3, 2004, 3.3 million shares of common stock have been issued since inception of the plan.

8—INCOME TAXES

The provision for income taxes consisted of the following for the respective years:

In millions	*2003*	*2002*	*2001*
Current:			
Federal	**$ 421.5**	$ 347.1	$ 360.3
State	**77.3**	57.0	53.9
	498.8	404.1	414.2
Deferred:			
Federal	**31.0**	32.0	(111.8)
State	**(1.6)**	3.1	(6.0)
	29.4	35.1	(117.8)
Total	**$ 528.2**	$ 439.2	$ 296.4

Following is a reconciliation of the statutory income tax rate to the Company's effective tax rate for the respective years:

	2003	*2002*	*2001*
Statutory income tax rate	**35.0%**	35.0%	35.0%
State income taxes, net of federal tax benefit	**3.6**	3.4	3.4
Goodwill and other[1]	**(0.2)**	(0.4)	1.0
Effective tax rate before Restructuring Charge	**38.4**	38.0	39.4
Restructuring Charge	**—**	—	2.4
Effective tax rate	**38.4%**	38.0%	41.8%

(1) Decrease in goodwill and other was primarily due to the elimination of goodwill amortization during 2002 that was not deductible for income tax purposes.

Following is a summary of the significant components of the Company's deferred tax assets and liabilities as of the respective balance sheet dates:

In millions	*JAN. 3, 2004*	*DEC. 28, 2002*
Deferred tax assets:		
Inventory	**$ 65.5**	$ 36.3
Restructuring Charge	**64.7**	73.1
Employee benefits	**55.9**	46.3
Lease and rents	**47.0**	43.9
Retirement benefits	**44.8**	53.9
Allowance for bad debt	**25.2**	27.1
Amortization method	**20.4**	29.9
Other	**82.0**	62.7
Total deferred tax assets	**405.5**	373.2
Deferred tax liabilities:		
Accelerated depreciation	**(195.0)**	(150.2)
Total deferred tax liabilities	**(195.0)**	(150.2)
Net deferred tax assets	**$ 210.5**	$ 223.0

Income taxes paid were $510.4 million, $319.5 million and $397.0 million for 2003, 2002 and 2001, respectively. The Company believes it is more likely than not that the deferred tax assets included in the above table will be realized during future periods in which the Company generates taxable earnings.

9—COMMITMENTS & CONTINGENCIES

Between 1991 and 1997, the Company sold or spun off a number of subsidiaries, including Bob's Stores, Linens 'n Things, Inc., Marshalls, Kay-Bee Toys, Wilsons, This End Up and Footstar, Inc. In many cases, when a former subsidiary leased a store, the Company provided a corporate level guarantee of the store's lease obligations. When the subsidiaries were disposed of, the Company's guarantees remained in place, although each purchaser indemnified the Company for any lease obligations the Company was required to satisfy. If any of the purchasers were to become insolvent and failed to make the required payments under a store lease, the Company could be required to satisfy these obligations. As of January 3, 2004, the Company guaranteed approximately 706 stores with leases extending through 2018. Assuming that each respective purchaser became insolvent, and the Company was required to assume all of these lease obligations, management estimates that the Company could settle the obligations for approximately $592 million as of January 3, 2004.

Management believes the ultimate disposition of any of the corporate level guarantees will not have a material adverse effect on the Company's consolidated financial condition, results of operations or future cash flows.

As of January 3, 2004, the Company had outstanding commitments to purchase $163 million of merchandise inventory for use in the normal course of business. The Company currently expects to satisfy these purchase commitments by 2008.

Beginning in August 2001, a total of nine actions were filed against the Company in the United States District Court for the District of Massachusetts asserting claims under the federal securities laws. The actions were subsequently consolidated under the caption *In re CVS Corporation Securities Litigation*, No. 01-CV-11464 (D. Mass.) and a consolidated and amended complaint was filed on April 8, 2002. The consolidated amended complaint names as defendants the Company, its chief executive officer and its chief financial officer and asserts claims for alleged securities fraud under sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder on behalf of a purported class of persons who purchased shares of the Company's common stock between February 6, 2001 and October 30, 2001. On June 7, 2002, all defendants moved to dismiss the consolidated amended complaint. This motion was denied by the court on December 18, 2002. The parties are currently engaged in discovery. The Company believes the consolidated action is without merit and intends to defend against it vigorously.

The Company is also a party to other litigation arising in the normal course of its business, none of which is expected to be material to the Company.

10—BUSINESS SEGMENTS

The Company currently operates two business segments, Retail Pharmacy and Pharmacy Benefit Management ("PBM").

The operating segments are segments of the Company for which separate financial information is available and for which operating results are evaluated regularly by executive management in deciding how to allocate resources and in assessing performance.

As of January 3, 2004, the Retail Pharmacy segment included 4,132 retail drugstores and the Company's online retail website, CVS.com. The retail drugstores are located in 27 states and the District of Columbia and operate under the CVS/pharmacy name. The Retail Pharmacy segment is the Company's only reportable segment.

The PBM segment provides a full range of prescription benefit management services to managed care providers and other organizations. These services include plan design and administration, formulary management, mail order pharmacy services, claims processing and generic substitution. The PBM segment also includes the Company's specialty pharmacy business, which focuses on supporting individuals that require complex and expensive drug therapies. The PBM segment operates under the PharmaCare Management Services name, while the specialty pharmacy mail order facilities and 47 retail pharmacies, located in 19 states and the District of Columbia, operate under the CVS ProCare name.

Following is a reconciliation of the significant components of the Company's net sales for the respective years:

	2003	*2002*	*2001*
Pharmacy	**68.8%**	67.6%	66.1%
Front store	**31.2**	32.4	33.9
	100.0%	100.0%	100.0%

The Company evaluates segment performance based on operating profit before the effect of nonrecurring charges and gains and certain intersegment activities and charges. The accounting policies of the segments are substantially the same as those described in Note 1.

Following is a reconciliation of the Company's business segments to the consolidated financial statements:

In millions	*RETAIL PHARMACY SEGMENT*	*PBM SEGMENT*	*OTHER ADJUSTMENTS[1]*	*CONSOLIDATED TOTALS*
2003:				
Net sales	**$ 25,280.7**	**$ 1,307.3**	**$ —**	**$ 26,588.0**
Operating profit	**1,323.1**	**100.5**	**—**	**1,423.6**
Depreciation and amortization	**326.5**	**15.2**	**—**	**341.7**
Total assets	**9,975.0**	**568.1**	**—**	**10,543.1**
Goodwill	**690.4**	**198.6**	**—**	**889.0**
Additions to property and equipment	**1,114.2**	**7.5**	**—**	**1,121.7**
2002:				
Net sales	$ 23,060.2	$ 1,121.3	$ —	$ 24,181.5
Operating profit	1,134.6	71.6	—	1,206.2
Depreciation and amortization	297.6	12.7	—	310.3
Total assets	9,132.1	513.2	—	9,645.3
Goodwill	690.4	188.5	—	878.9
Additions to property and equipment	1,104.5	4.3	—	1,108.8
2001:				
Net sales	$ 21,328.7	$ 912.7	$ —	$ 22,241.4
Operating profit	1,079.9	39.7	(349.0)	770.6
Depreciation and amortization	301.7	19.1	—	320.8
Total assets	8,131.8	504.5	—	8,636.3
Goodwill	688.7	186.2	—	874.9
Additions to property and equipment	705.3	8.3	—	713.6

(1) In 2001, other adjustments relate to the $352.5 million Restructuring Charge and the $3.5 million Net Litigation Gain. See Note 11 for further information on the Restructuring Charge and Note 1 for further information on the Net Litigation Gain. Nonrecurring charges and gains are not considered when management assesses the stand-alone performance of the Company's business segments.

11—RESTRUCTURING & ASSET IMPAIRMENT CHARGE

During the fourth quarter of 2001, management approved a strategic restructuring, which resulted from a comprehensive business review designed to streamline operations and enhance operating efficiencies.

Following is a summary of the specific initiatives contained in the 2001 strategic restructuring:

1. 229 CVS/pharmacy and CVS ProCare store locations (the "Stores") would be closed by no later than March 2002. Since these locations were leased facilities, management planned to either return the premises to the respective landlords at the conclusion of the current lease term or negotiate an early termination of the contractual obligations. As of March 31, 2002, all of the Stores had been closed.

2. The Henderson, North Carolina distribution center (the "D.C.") would be closed and its operations would be transferred to the Company's remaining distribution centers by no later than May 2002. Since this location was owned, management planned to sell the property upon closure. The D.C. was closed in April 2002 and sold in May 2002.

3. The Columbus, Ohio mail order facility (the "Mail Facility") would be closed and its operations would be transferred to the Company's Pittsburgh, Pennsylvania mail order facility by no later than April 2002. Since this location was a leased facility, management planned to either return the premises to the landlord at the conclusion of the lease or negotiate an early termination of the contractual obligation. The Mail Facility was closed in March 2002.

4. Two satellite office facilities (the "Satellite Facilities") would be closed and their operations would be consolidated into the Company's Woonsocket, Rhode Island corporate headquarters by no later than December 2001. Since these locations were leased facilities, management planned to either return the premises to the landlords at the conclusion of the leases or negotiate an early termination of the contractual obligations. The Satellite Facilities were closed in December 2001.

5. Approximately 1,500 managerial, administrative and store employees in the Company's Woonsocket, Rhode Island corporate headquarters; Columbus Mail Facility; Henderson D.C. and the Stores would be terminated. As of April 30, 2002, all of these employees had been terminated.

In accordance with Emerging Issues Task Force ("EITF") Issue 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)," SFAS No. 121 and Staff Accounting Bulletin No. 100, "Restructuring and Impairment Charges," the Company recorded a $346.8 million pre-tax charge ($226.9 million after-tax) to operating expenses during the fourth quarter of 2001 for restructuring and asset impairment costs. In accordance with Accounting Research Bulletin No. 43, "Restatement and Revision of Accounting Research Bulletins," the Company also recorded a $5.7 million pre-tax charge ($3.6 million after-tax) to cost of goods sold during the fourth quarter of 2001 to reflect the markdown of certain inventory contained in the Stores to its net realizable value. In total, the restructuring and asset impairment charge was $352.5 million pre-tax ($230.5 million after-tax), or $0.56 per diluted share in 2001 (the "Restructuring Charge"). The aggregate impact of the 229 stores on the Company's consolidated financial statements for the year ended December 29, 2001, totaled $585.3 million in net sales and $13.7 million in operating losses, which included depreciation and amortization of $12.4 million, incremental markdowns incurred in connection with liquidating inventory and incremental payroll and other store-related costs incurred in connection with closing and/or preparing the 229 stores for closing. Whenever possible, the Company attempts to transfer the customer base of its closed stores to adjacent CVS store locations. The Company's success in retaining customers and the related impact on the above revenue and operating income or loss, however, cannot be precisely calculated.

Following is a summary of the significant components of the Restructuring Charge:

In millions	
Noncancelable lease obligations	$ 227.4
Asset write-offs	105.6
Employee severance and benefits	19.5
Total[(1)]	$ 352.5

(1) The Restructuring Charge is comprised of $5.7 million recorded in cost of goods sold and $346.8 million recorded in selling, general and administrative expenses.

The Restructuring Charge will require total cash payments of $246.9 million. The remaining Restructuring Charge liability totaled $168.9 million as of January 3, 2004 and $192.1 million as of December 28, 2002. The remaining liability in both years primarily consisted of future cash payments for noncancelable lease obligations extending through 2024. The Company believes that the reserve balances as of January 3, 2004 are adequate to cover the remaining liabilities associated with the Restructuring Charge.

Noncancelable lease obligations included $227.4 million for the estimated continuing lease obligations of the Stores, the Mail Facility and the Satellite Facilities. As required by EITF Issue 88-10, "Costs Associated with Lease Modification or Termination," the estimated continuing lease obligations were reduced by estimated probable sublease rental income.

Asset write-offs included $59.0 million for fixed asset write-offs, $40.9 million for intangible asset write-offs and $5.7 million for the markdown of certain inventory to its net realizable value. The fixed asset and intangible asset write-offs relate to the Stores, the Mail Facility and the Satellite Facilities. Management's decision to close the above locations was considered to be an event or change in circumstances as defined in SFAS No. 121. Since management intended to use the Stores and the Mail Facility on a short-term basis during the shutdown period, impairment was measured using the "Assets to Be Held and Used" provisions of SFAS No. 121. The analysis was prepared at the individual location level, which is the lowest level at which individual cash flows can be identified. The analysis first compared the carrying amount of the location's assets to the location's estimated future cash flows (undiscounted and without interest charges) through the anticipated closing date. If the estimated future cash flows used in this analysis were less than the carrying amount of the location's assets, an impairment loss calculation was prepared. The impairment loss calculation compared the carrying value of the location's assets to the location's estimated future cash flows (discounted and with

interest charges). Since these locations will continue to be operated until closed, any remaining net book value after the impairment write-down was depreciated over their revised useful lives. Impairment of the Satellite Facilities was measured using the "Assets to Be Disposed Of" provisions of SFAS No. 121, since management intended to vacate the locations immediately. The entire $3.5 million net book value of the Satellite Facilities was considered to be impaired since management intended to discard the assets located in the facilities. The inventory markdown resulted from the liquidation of certain front store inventory contained in the Stores. Since management intended to liquidate the inventory below its cost, an adjustment was made to reduce the inventory's cost to its net realizable value.

Employee severance and benefits included $19.5 million for severance pay, healthcare continuation costs and outplacement service costs related to approximately 1,500 managerial, administrative and store employees in the Company's Woonsocket, Rhode Island corporate headquarters; Columbus, Mail Facility; Henderson D.C. and the Stores. As of April 30, 2002, all these employees had been terminated.

12—RECONCILIATION OF EARNINGS PER COMMON SHARE

Following is a reconciliation of basic and diluted earnings per common share for the respective years:

In millions, except per share amounts	*2003*	*2002*	*2001*
NUMERATOR FOR EARNINGS PER COMMON SHARE CALCULATION:			
Net earnings	**$ 847.3**	$ 716.6	$ 413.2
Preference dividends, net of income tax benefit	**(14.6)**	(14.8)	(14.7)
Net earnings available to common shareholders, basic	**$ 832.7**	$ 701.8	$ 398.5
Net earnings	**$ 847.3**	$ 716.6	$ 413.2
Dilutive earnings adjustment	**(6.3)**	(6.7)	(4.8)
Net earnings available to common shareholders, diluted	**$ 841.0**	$ 709.9	$ 408.4
DENOMINATOR FOR EARNINGS PER COMMON SHARE CALCULATION:			
Weighted average common shares, basic	**394.4**	392.3	392.2
Effect of dilutive securities:			
Preference stock	**10.6**	10.7	10.8
Stock options	**2.7**	2.3	5.3
Weighted average common shares, diluted	**407.7**	405.3	408.3
BASIC EARNINGS PER COMMON SHARE:			
Net earnings	**$ 2.11**	$ 1.79	$ 1.02
DILUTED EARNINGS PER COMMON SHARE:			
Net earnings	**$ 2.06**	$ 1.75	$ 1.00

13—QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Dollars in millions, except per share amounts	*FIRST QUARTER*	*SECOND QUARTER*	*THIRD QUARTER*	*FOURTH QUARTER*	*FISCAL YEAR*
2003:					
Net sales	**$ 6,312.8**	**$ 6,444.9**	**$ 6,378.1**	**$ 7,452.2**	**$ 26,588.0**
Gross margin	**1,605.5**	**1,633.8**	**1,658.6**	**1,965.1**	**6,863.0**
Operating profit	**331.3**	**337.0**	**316.7**	**438.6**	**1,423.6**
Net earnings	**196.3**	**199.8**	**187.8**	**263.4**	**847.3**
Net earnings per common share, basic	**0.49**	**0.50**	**0.47**	**0.66**	**2.11**
Net earnings per common share, diluted	**0.48**	**0.49**	**0.46**	**0.64**	**2.06**
Dividends per common share	**0.0575**	**0.0575**	**0.0575**	**0.0575**	**0.2300**
Stock price: (New York Stock Exchange)					
High	**26.67**	**28.50**	**32.60**	**37.46**	**37.46**
Low	**21.99**	**23.08**	**27.43**	**31.06**	**21.99**
Registered shareholders at year-end					**9,300**
2002:					
Net sales	$ 5,970.7	$ 5,989.5	$ 5,876.4	$ 6,344.9	$ 24,181.5
Gross margin	1,493.7	1,481.1	1,481.3	1,612.7	6,068.8
Operating profit	296.5	298.3	276.5	334.9	1,206.2
Net earnings	175.7	176.4	164.4	200.1	716.6
Net earnings per common share, basic	0.44	0.44	0.41	0.50	1.79
Net earnings per common share, diluted	0.43	0.43	0.40	0.49	1.75
Dividends per common share	0.0575	0.0575	0.0575	0.0575	0.2300
Stock price: (New York Stock Exchange)					
High	35.40	35.58	31.30	28.70	35.58
Low	25.80	30.60	24.42	23.99	23.99

Five-Year Financial Summary

In millions, except per share amounts	*2003 (53 WEEKS)*	*2002 (52 WEEKS)*	*2001 (52 WEEKS)*	*2000 (52 WEEKS)*	*1999 (53 WEEKS)*
STATEMENT OF OPERATIONS DATA:					
Net sales	**$ 26,588.0**	$ 24,181.5	$ 22,241.4	$ 20,087.5	$ 18,098.3
Gross margin[1]	**6,863.0**	6,068.8	5,691.0	5,361.7	4,861.4
Selling, general and administrative expenses	**5,097.7**	4,552.3	4,256.3	3,761.6	3,488.0
Depreciation and amortization[2]	**341.7**	310.3	320.8	296.6	277.9
Merger, restructuring and other nonrecurring charges and (gains)	**—**	—	343.3	(19.2)	—
Total operating expenses	**5,439.4**	4,862.6	4,920.4	4,039.0	3,725.9
Operating profit[3]	**1,423.6**	1,206.2	770.6	1,322.7	1,135.5
Interest expense, net	**48.1**	50.4	61.0	79.3	59.1
Income tax provision	**528.2**	439.2	296.4	497.4	441.3
Net earnings[4]	**$ 847.3**	$ 716.6	$ 413.2	$ 746.0	$ 635.1
PER COMMON SHARE DATA:					
Net earnings:[4]					
Basic	**$ 2.11**	$ 1.79	$ 1.02	$ 1.87	$ 1.59
Diluted	**2.06**	1.75	1.00	1.83	1.55
Cash dividends per common share	**0.230**	0.230	0.230	0.230	0.230
BALANCE SHEET AND OTHER DATA:					
Total assets	**$ 10,543.1**	$ 9,645.3	$ 8,636.3	$ 7,949.5	$ 7,275.4
Long-term debt	**753.1**	1,076.3	810.4	536.8	558.5
Total shareholders' equity	**6,021.8**	5,197.0	4,566.9	4,304.6	3,679.7
Number of stores (at end of period)	**4,179**	4,087	4,191	4,133	4,098

(1) Gross margin includes the pre-tax effect of the following nonrecurring charges: (i) in 2001, $5.7 million ($3.6 million after-tax) related to the markdown of certain inventory contained in the stores closing as part of the strategic restructuring, discussed in Note 11 to the consolidated financial statements, to its net realizable value.

(2) As a result of adopting SFAS No. 142, "Goodwill and Other Intangible Assets," at the beginning of 2002, the Company no longer amortizes goodwill and other indefinite-lived intangible assets. Goodwill amortization totaled $31.4 million pre-tax ($28.2 million after-tax) in 2001, $33.7 million pre-tax ($31.9 million after-tax) in 2000 and $38.9 million pre-tax ($38.1 million after-tax) in 1999.

(3) Operating profit includes the pre-tax effect of the charges discussed in Note (1) above and the following merger, restructuring and other nonrecurring charges and gains: (i) in 2001, $346.8 million ($226.9 million after-tax) related to restructuring and asset impairment costs associated with the strategic restructuring and the $3.5 million ($2.1 million after-tax) net nonrecurring gain resulting from the net effect of the $50.3 million of settlement proceeds received from various lawsuits against certain manufacturers of brand name prescription drugs and the Company's contribution of $46.8 million of these settlement proceeds to the CVS Charitable Trust, Inc. to fund future charitable giving, and (ii) in 2000, $19.2 million ($11.5 million after-tax) nonrecurring gain representing partial payment of our share of the settlement proceeds from a class action lawsuit against certain manufacturers of brand name prescription drugs.

(4) Net earnings and net earnings per common share include the after-tax effect of the charges and gains discussed in Notes (1) and (3) above.

Management's Responsibility for Financial Reporting

We are responsible for the preparation and integrity of the consolidated financial statements appearing in this Annual Report. The financial statements were prepared in conformity with accounting principles generally accepted in the United States of America and include certain amounts based on our best estimates and judgments.

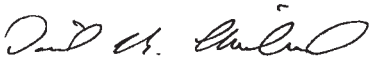
We are responsible for maintaining a system of internal accounting controls and procedures to provide reasonable assurance, at an appropriate cost/benefit relationship, that assets are safeguarded and that transactions are authorized, recorded and reported properly. Our internal accounting control system is enhanced by periodic reviews by our internal auditors and independent auditors, written policies and procedures and a written Code of Conduct adopted by our Company's Board of Directors, applicable to all employees of our Company. In addition, we have an internal Disclosure Committee, comprised of management from each functional area within the Company, which performs a separate review of our disclosure controls.

In our opinion, our Company's internal accounting controls provide reasonable assurance that assets are safeguarded and that the financial records are reliable for preparing financial statements.

The Audit Committee of our Board of Directors, consisting solely of independent directors, is responsible for monitoring the Company's accounting and reporting practices. The Audit Committee meets periodically with management, the internal auditors and the independent auditors to review matters relating to the Company's financial reporting, the adequacy of internal accounting controls and the scope and results of audit work. The internal auditors and independent auditors have full and free access to the Audit Committee.

KPMG LLP, independent auditors, are appointed by the Board of Directors and ratified by our Company's shareholders. They were engaged to render an opinion regarding the fair presentation of our consolidated financial statements. Their accompanying report is based upon an audit conducted in accordance with auditing standards generally accepted in the United States of America and included a review of the system of internal accounting controls to the extent they considered necessary to support their opinion.

Thomas M. Ryan
Chairman of the Board, President and
Chief Executive Officer



David B. Rickard
Executive Vice President, Chief Financial Officer and
Chief Administrative Officer

February 6, 2004

Independent Auditors' Report

KPMG

Board of Directors and Shareholders
CVS Corporation:

We have audited the accompanying consolidated balance sheets of CVS Corporation and subsidiaries as of January 3, 2004 and December 28, 2002, and the related consolidated statements of operations, shareholders' equity, and cash flows for the fifty-three week period ended January 3, 2004 and the fifty-two week periods ended December 28, 2002 and December 29, 2001. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of CVS Corporation and subsidiaries as of January 3, 2004, and December 28, 2002, and the results of their operations and their cash flows for the fifty-three week period ended January 3, 2004 and the fifty-two week periods ended December 28, 2002 and December 29, 2001, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 4 to the consolidated financial statements, CVS Corporation and subsidiaries adopted the provisions of Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, in 2002. As discussed in Note 1 to the consolidated financial statements, CVS Corporation and subsidiaries adopted the provisions of Emerging Issues Task Force Issue No. 02-16, Accounting by a Reseller for Cash Consideration received from a Vendor, in 2003.

KPMG LLP

KPMG LLP
Providence, Rhode Island
February 6, 2004

OFFICERS

Thomas M. Ryan
Chairman of the Board, President and Chief Executive Officer

David B. Rickard
Executive Vice President, Chief Financial Officer and Chief Administrative Officer

Chris W. Bodine
Executive Vice President–Merchandising and Marketing

Larry J. Merlo
Executive Vice President–Stores

Douglas A. Sgarro
Executive Vice President–Strategy and Chief Legal Officer

President
CVS Realty Co.

V. Michael Ferdinandi
Senior Vice President–Human Resources and Corporate Communications

Philip C. Galbo
Senior Vice President and Treasurer

Larry D. Solberg
Senior Vice President–Finance and Controller

Nancy R. Christal
Vice President–Investor Relations

Gregory S. Weishar
Vice President

President and Chief Executive Officer
PharmaCare

Zenon P. Lankowsky
Secretary

DIRECTORS

W. Don Cornwell[2][3]
Chairman of the Board and Chief Executive Officer
Granite Broadcasting Corporation

Thomas P. Gerrity[1]
Professor of Management
The Wharton School of the University of Pennsylvania

Stanley P. Goldstein
Retired; formerly Chairman of the Board and Chief Executive Officer
CVS Corporation

Marian L. Heard[1][3]
President and Chief Executive Officer
United Way of Massachusetts Bay

Chief Executive Officer
United Ways of New England

William H. Joyce[1][3]
Chairman of the Board and Chief Executive Officer
Nalco Company

Terry R. Lautenbach[2][3]
Retired; formerly Senior Vice President
International Business Machines Corporation

Terrence Murray
Retired; formerly Chairman of the Board and Chief Executive Officer
FleetBoston Financial Corporation

Sheli Z. Rosenberg[2][3]
Retired; formerly President, Chief Executive Officer and Vice Chairman
Equity Group Investments, LLC

Thomas M. Ryan
Chairman of the Board, President and Chief Executive Officer
CVS Corporation

(1) Member of the Audit Committee.

(2) Member of the Management Planning and Development Committee.

(3) Member of the Nominating and Corporate Governance Committee.

SHAREHOLDER INFORMATION

Corporate Headquarters
CVS Corporation
One CVS Drive, Woonsocket, RI 02895
(401) 765-1500

Annual Shareholders' Meeting
11:00 a.m. May 12, 2004
CVS Corporate Headquarters

Stock Market Listing
New York Stock Exchange
Symbol: CVS

Transfer Agent and Registrar
Questions regarding stock holdings, certificate replacement/transfer, dividends and address changes should be directed to:
The Bank of New York
Shareholder Relations Department
P.O. Box 11258
Church Street Station
New York, NY 10286
Toll-free: (877) CVSPLAN (287-7526)
E-mail: shareowner-svcs@bankofny.com

Direct Stock Purchase/Dividend Reinvestment Program
BuyDIRECT℠ provides a convenient and economical way for you to purchase your first shares or additional shares of CVS common stock. The program is sponsored and administered by The Bank of New York. For more information, including an enrollment form, please contact:
The Bank of New York at (877) 287-7526

Financial and Other Company Information
The Company's Annual Report on Form 10-K will be sent without charge to any shareholder upon request by contacting:
Nancy R. Christal
Vice President–Investor Relations
CVS Corporation
670 White Plains Road–Suite 210
Scarsdale, NY 10583
(800) 201-0938

In addition, financial reports and recent filings with the Securities and Exchange Commission, including our Form 10-K, as well as other Company information, are available via the Internet at http://investor.cvs.com.

Design: RKC! (Robinson Kurtin Communications! Inc.) Photography: Bob Day, Burk Uzzle Printing: Hennegan

CVS easy at work

Our Vision:

We help people live longer, healthier, happier lives.

Our Mission:

We will be the easiest pharmacy retailer for customers to use.

Our Values for Success:

Respect for individuals
Integrity
Teamwork
Openness to new ideas
Commitment to flawless execution
Passion for extraordinary customer service

CVS/pharmacy®

CVS Corporation, One CVS Drive, Woonsocket, RI 02895